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THE CORPORATE ATTORNEY-CLIENT PRIVILEGE IN THE FEDERAL COURTS*

INTRODUCTION

Since the reign of the Tudors, English law has recognized the attorney-client privilege on the theory that an attorney owes a duty of loyalty to his client.¹ Although numerous justifications for the privilege have been advanced,² it is widely assumed that the privilege exists today to encourage free consultation and exchange of information between attorney and client.³ Thus, the privilege bars disclosure of confidential communications

* This article is a student work prepared by Allen A. Hans, a member of the ST. JOHN'S LAW REVIEW and the St. Thomas More Institute for Legal Research.

¹ The early English concept of privilege, grounded on the theory that it was an attorney's duty to preserve the confidences of his client, was considered a "point of honor" not to be breached by the client's representative. 8 J. WIGMORE, EVIDENCE § 2290, at 543 (McNaughton rev. ed. 1961) [hereinafter cited as WIGMORE]. Indeed, it is possible that the origins of the attorney-client privilege date back to Roman times, where, as a matter of fidelity between master and servant, "[a]dvocates . . . could not be called as witnesses against their clients while the case was in progress." Radin, *The Privilege of Confidential Communications Between Lawyer and Client*, 16 CALIF. L. REV. 487, 488 (1928). The nexus between the Roman concept of loyalty and the Elizabethan view of integrity is a tenuous one at best; nevertheless, both principles evidence an early desire to ensure confidence between a client and his legal representative.

² For an indepth discussion of the history and purpose of the privilege, see Gardner, *A Re-evaluation of the Attorney-Client Privilege* (pts. 1 & 2), 8 VILL. L. REV. 279, 447 (1963). In *Annesley v. Earl of Anglesea*, 17 How. St. Tr. 1139 (1743), the proposition is asserted that a vital privilege is a necessary concomitant to the functioning of a modern industrial economy. In so concluding, the court opined: "[A]ll people and all courts have looked upon that confidence between the party and attorney to be so great, that it would be destructive to all business, if attorneys were to disclose the business of their clients" *Id.* at 1226.

³ In his discussion of the modern policy underlying the attorney-client privilege, Dean Wigmore states: "In order to promote freedom of consultation of legal advisers by clients, the apprehension of compelled disclosure by the legal advisers must be removed; hence the law must prohibit such disclosure except on the client's consent." 8 WIGMORE, *supra* note 1, § 2291, at 545. See also *Chirac v. Reinicker*, 24 U.S. (11 Wheat.) 280, 294 (1826); Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 953, 954 (1956) [hereinafter cited as Simon].

between attorney and client on the principle that the possibility of divulgence of such communications would inhibit the "unrestricted and unbounded confidence"⁴ which is essential for the preservation of the client's legal rights.⁵ Although the theory on which the privilege operates has been widely recognized and accepted, federal courts have imposed a number of restrictions upon its availability. The chief reason for these restrictions has been the fear that the privilege may run afoul of the policy of liberal pretrial discovery.⁶ Moreover, its application has been subject to uncer-

⁴ *United States v. Kovel*, 296 F.2d 918, 921 (2d Cir. 1961).

⁵ Judge Kaufman, now Chief Judge of the Court of Appeals for the Second Circuit, has noted that although certain confidential attorney-client communications may have independent evidentiary value, "their revelation will impair the social good derived from the proper performance of the functions of lawyers for their clients." *Comercio E Indus. Continental, S.A. v. Dresser Indus.*, 19 F.R.D. 513, 514 (S.D.N.Y. 1956).

The conditions necessary for the privilege to attach have been well defined:

(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.

8 WIGMORE, *supra* note 1, § 2292, at 554 (footnote omitted). For an alternative and more detailed statement of the availability of the privilege, see *United States v. United Shoe Mach. Corp.*, 89 F.Supp. 357, 358-59 (D. Mass. 1950) (Wyzanski, J.).

In spite of the broad scope of the privilege there have been limitations placed upon its applicability. See, e.g., *Giordani v. Hoffman*, 278 F. Supp. 886 (E.D. Pa. 1968), wherein the court, applying Pennsylvania law, qualified the privilege by holding that it embraces only those communications acquired by the attorney by virtue of his professional relationship with the client, "not . . . those facts with which counsel may become acquainted collaterally" *Id.* at 889. When the conditions precedent necessary for the privilege to attach have been met, the attorney is duty bound to assert the privilege in his client's behalf. See, e.g., *Tillotson v. Boughner*, 350 F.2d 663, 665 (7th Cir. 1965); *Schwimmer v. United States*, 232 F.2d 855, 863 (8th Cir.), *cert. denied*, 352 U.S. 833 (1956); cf. ABA CODE OF PROFESSIONAL RESPONSIBILITY No. 4, EC 4-4. The ethical considerations concerning an attorney betraying his client's confidences are stronger, both in scope and duration, than is the evidentiary attorney-client privilege. See, e.g., *Doe v. A. Corp.*, 330 F. Supp. 1352 (S.D.N.Y. 1971), *aff'd sub nom.* *Hall v. A. Corp.*, 453 F.2d 1375 (2d Cir. 1972) (*per curiam*). Before the action was commenced, plaintiff Doe was an attorney associated with a law firm representing defendant corporations. Upon termination of his relationship with the firm, Doe purchased one share of stock of the A. Corporation and brought a derivative action, charging the individual defendants, officers, and directors of the defendant corporations, with fraud, breach of fiduciary duty, and violations of the federal securities laws. Doe had acquired the information upon which he based his complaint in the course of the prior attorney-client relationship. Relying upon Canon 4, the court held that "where any substantial relationship" can be shown between counsel's former representation and subsequent litigation in which the attorney is involved, his participation in the latter will be prohibited. 330 F. Supp. at 1355, *quoting* *T.C. Theatre Corp. v. Warner Bros. Pictures*, 113 F. Supp. 265, 268 (S.D.N.Y. 1953). See generally Note, *Disqualification of Attorneys for Representing Interests Adverse to Former Clients*, 64 YALE L.J. 917 (1955).

⁶ The Supreme Court has noted that discovery is designed to "make a trial less of a game of blindman's buff [*sic*] and more a fair contest with the basic issues and facts disclosed to

tainty due to a lack of clear statutory guidelines.⁷

Notwithstanding one contrary district court opinion,⁸ it is well settled that the corporate client enjoys the benefits of the attorney-client privilege.⁹ Nevertheless, courts have encountered problems when called upon

the fullest practicable extent." *United States v. Proctor & Gamble Co.*, 356 U.S. 677, 682 (1958). Accordingly, consistent with their function, *viz.*, to frame issues, eliminate surprise, and expose fraudulent and groundless claims, the discovery rules, FED. R. CIV. P. 26-37, are liberally construed in favor of the party seeking pretrial information. 8 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 2001, at 17 (1970). The attorney-client privilege, however, impedes the search for truth by shielding information relevant to the controversy at hand. Dean Wigmore has noted that the scope of the privilege should be construed restrictively since its "benefits are indirect and speculative; its obstruction is plain and concrete." 8 WIGMORE, *supra* note 1, § 2291, at 554. *But see* Hawkins, *Discovery and Rule 34: What's So Wrong About Surprise?*, 39 A.B.A.J. 1075 (1953). *See also* *Greyhound Lines, Inc. v. Miller*, 402 F.2d 134, 143 (8th Cir. 1968).

⁷ Unlike most state courts, which can define the boundaries of the privilege by resort to statutory language, *see, e.g.*, N.Y. CIV. PRAC. LAW & RULES § 4503 (McKinney 1963), federal courts must look exclusively to the common law to derive the scope of the privilege. Unfortunately, federal courts are often forced to reconcile a mass of conflicting judicial precedents. For example, prior to enactment of the Federal Rules of Evidence, the Eighth Circuit utilized the law of privilege of the forum state in federal question cases. *Love v. United States*, 386 F.2d 260 (8th Cir. 1967), *cert. denied*, 390 U.S. 985 (1968). The Ninth Circuit held that in the absence of a clear congressional mandate, state law should govern. *Baird v. Koerner*, 279 F.2d 623 (9th Cir. 1960), *noted in* 49 CALIF. L. REV. 382 (1961); 109 U. PA. L. REV. 1030 (1961). The majority of circuits, however, have applied the federal common law of privilege, notwithstanding the existence of pendent state claims. *See, e.g.*, *Carr v. Monroe Mfg. Co.*, 431 F.2d 384 (5th Cir. 1970), *cert. denied*, 400 U.S. 1000 (1971); *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); *In re Albert Lindley Memorial Hosp.*, 209 F.2d 122 (2d Cir. 1953), *cert. denied*, 347 U.S. 960 (1954). *See generally* Louisell, *Confidentiality, Conformity and Confusion: Privileges in the Federal Courts Today*, 31 TUL. L. REV. 101 (1956).

In cases based on diversity of citizenship, federal courts have held that the privilege is a substantive right governed by *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). Accordingly, in such actions courts will apply the privilege law of the forum state. *See, e.g.*, *Hyde Constr. Co. v. Koehring Co.*, 455 F.2d 337 (5th Cir. 1972); *Republic Gear Co. v. Borg-Warner Corp.*, 381 F.2d 551 (2d Cir. 1967) (dictum); *New York Underwriters Ins. Co. v. Union Constr. Co.*, 285 F. Supp. 868 (D. Kan. 1968) (mem.). *Contra*, *Scourtes v. Fred W. Albrecht Grocery Co.*, 15 F.R.D. 55 (N.D. Ohio 1953) (per curiam). *See generally* 4 J. MOORE, *FEDERAL PRACTICE* ¶ 26.60[7] (2d ed. 1976).

To rectify such problems, detailed rules concerning the thrust of the privilege were proposed. Proposed Rules of Evidence for the United States District Courts and Magistrates, R. 5-03 (Preliminary Draft 1969), in 46 F.R.D. 161, 249. The Advisory Committee proposed 13 separate rules concerning the scope of the privilege. Congress, however, opted for one general rule which effectively settled only the choice of law problem by providing the privilege to be a substantive question governed by *Erie* principles. *See* H.R. REP. NO. 650, 93d Cong., 1st. Sess. (1973).

⁸ *See* *Radiant Burners, Inc. v. American Gas Ass'n*, 207 F. Supp. 771 (N.D. Ill.), *opinion supplemented*, 209 F. Supp. 321 (N.D. Ill. 1962), *rev'd*, 320 F.2d 314 (7th Cir.) (en banc), *cert. denied*, 375 U.S. 929 (1963), *discussed in* notes 17-21 and accompanying text *infra*.

⁹ *See, e.g.*, *Bell v. Maryland*, 378 U.S. 226, 263 app. I (1964) ("a corporation like any other

to determine which agents of the corporation are entitled to have their communications with counsel shielded by the privilege. Many courts have extended the benefits of the privilege only to those agents of the corporation who possess a high degree of control over the corporate decisionmaking process.¹⁰ Other courts have developed a more liberal rule, holding that nearly all corporate agents who speak with counsel about corporate activities are entitled to invoke the privilege on its behalf.¹¹ Recently, one court, dissatisfied with the limitations inherent in either approach, has fashioned a new test in an attempt to attune the corporate client's privilege more closely to modern business realities.¹²

At the same time, the class of persons against whom the corporation's privilege may be invoked has been restricted. This development has been most noticeable in shareholder suits in which management attempts to assert the privilege against those people who are, in actuality, the owners of the corporate client. In such instances, courts have weighed the corporation's right to the privilege against the purposes to be served by disclosure and, in many cases, have held that the privilege does not attach. Thus, in situations where a fiduciary relationship exists between the corporation and its shareholders, a number of courts have refused, upon a showing of good cause by plaintiff shareholders, to allow the attorney-client privilege to be invoked in the corporation's behalf.¹³ Recently, in the context of parent-subsidary relations, in which the parent corporation serves in a dual fiduciary capacity, *viz.*, to its own shareholders on the one hand, and the minority shareholders of its subsidiary on the other, it has been held that the interest of the minority shareholders of the subsidiary outweighs any necessity for the parent to invoke the privilege in suits between them.¹⁴ This represents yet another constriction of the class of persons against

'client' is entitled to invoke the attorney-client privilege"); *Radiant Burners, Inc. v. American Gas Ass'n*, 320 F.2d 314 (7th Cir.) (en banc), *cert. denied*, 375 U.S. 929 (1963), *rev'g*, 207 F. Supp. 771 (N.D. Ill. 1962) (recognition of privilege afforded to corporate client). *See also* Heininger, *The Attorney-Client Privilege as It Relates to Corporations*, 53 *ILL. B.J.* 376 (1965).

¹⁰ *See, e.g.*, *City of Philadelphia v. Westinghouse Elec. Corp.*, 210 F. Supp. 483 (E.D. Pa.), *mandamus and prohibition denied sub nom. General Elec. Co. v. Kirkpatrick*, 312 F.2d 742 (3d Cir. 1962), *cert. denied*, 372 U.S. 943 (1963), *discussed in* notes 24-32 and accompanying text *infra*.

¹¹ *See, e.g.*, *Harper & Row Publishers, Inc. v. Decker*, 423 F.2d 487 (7th Cir. 1970) (*per curiam*), *aff'd per curiam by an equally divided Court*, 400 U.S. 348 (1971), *discussed in* notes 38-43 and accompanying text *infra*. *Contra*, *Virginia Elec. & Power Co. v. Sun Shipbuilding & Dry Dock Co.*, 68 F.R.D. 397, 400 (E.D. Va. 1975) ("rule most likely to obtain the greatest discovery" should be applied).

¹² *See* *Duplan Corp. v. Deering-Milliken, Inc.*, 397 F. Supp. 1146 (D.S.C. 1975), *discussed in* notes 52-59 and accompanying text *infra*.

¹³ *See, e.g.*, *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971), *discussed in* notes 86-95 and accompanying text *infra*.

¹⁴ *See* *Valente v. PepsiCo, Inc.*, 68 F.R.D. 361 (D. Del. 1975) (mem.).

whom the corporation's privilege may be claimed. Opportunities for abuse are many in these situations and close scrutiny by the courts is necessary.¹⁵

In light of the aforementioned considerations, it is clear that without unifying guidelines balkanization of the attorney-client privilege in the federal courts will continue, effectively jeopardizing its operation. As various courts attempt to delineate the scope of the privilege, further segmentation will necessarily result, thereby eroding the certainty which is necessary to ensure the proper functioning of any evidentiary privilege. This Note will attempt to reconcile the mass of conflicting precedents dealing with the privilege and propose what is hoped will be a workable attorney-client privilege in the corporate arena.

AVAILABILITY OF THE PRIVILEGE TO THE CORPORATE CLIENT

It had long been assumed by both courts and commentators that the corporation was to be considered a client for purposes of invoking the attorney-client privilege.¹⁶ In 1962, however, in a decision of far-reaching importance, Judge Campbell, in *Radiant Burners, Inc. v. American Gas Association*,¹⁷ refused to extend the privilege to an association of natural gas utilities on the theory that the privilege was intended to "be claimed only by natural individuals and not by mere corporate entities."¹⁸ Though

¹⁵ See notes 112-161 and accompanying text *infra*.

¹⁶ See, e.g., *United States v. Louisville & Nash. R.R.*, 236 U.S. 318 (1915), a mandamus action brought by the ICC to compel defendants to permit inspection of their accounts, correspondence, and records. Upon a plea by the railroads objecting to disclosure, the Court ruled that the inspection could not "include the confidential correspondence of the railroad companies between itself and its counsel" *Id.* at 336. See also *Cole v. Hughes Tool Co.*, 215 F.2d 924, 930-31 (10th Cir. 1954), *cert. denied*, 348 U.S. 927 (1955); *Ellis-Foster Co. v. Union Carbide & Carbon Corp.*, 159 F. Supp. 917 (D.N.J. 1958); Simon, *supra* note 3, at 953; note 9 *supra*.

¹⁷ 207 F. Supp. 771 (N.D. Ill.), *opinion supplemented*, 209 F. Supp. 321 (N.D. Ill. 1962), *rev'd*, 320 F.2d 314 (7th Cir.) (en banc), *cert. denied*, 375 U.S. 929 (1963).

¹⁸ 207 F. Supp. at 773. In reaching its conclusion, the court first determined that the matter of the corporate privilege was an open question and then proceeded to hold that no such privilege existed. Initially, the court noted that the privilege is historically and fundamentally personal in nature and that a corporation should not be afforded a privilege originally created to benefit natural persons. The court analogized the attorney-client privilege to the fifth amendment privilege against self-incrimination which is not available to artificial persons. See, e.g., *Wilson v. United States*, 221 U.S. 361 (1911); *Hale v. Henkel*, 201 U.S. 43 (1906); *cf.* Note, *The Constitutional Rights of Associations to Assert the Privilege Against Self-Incrimination*, 112 U. PA. L. REV. 394 (1964).

Furthermore, recognition of the attorney-client privilege requires that the communications originate in confidence and continue to bear the cloak of confidentiality. See generally 8 WIGMORE, *supra* note 1, § 2311, at 599-603. The court noted that such confidentiality cannot exist in the case of a corporation, which by its very nature can only communicate through agents. Moreover, it would be difficult to determine which agents and papers should come within the purview of the privilege. The court also recognized that directors of large corpora-

promptly reversed,¹⁹ *Radiant Burners* has had a profound impact upon later decisions which attempted to define and delineate the thrust of the privilege available to the corporate client. Focusing upon the possibilities of abuse which might result from permitting large corporations to assert the privilege and thereby extend its "zone of silence"²⁰ beyond reasonable bounds, courts influenced by Judge Campbell's decision have restricted the number of agents of the corporation entitled to speak on its behalf.²¹

The Control Group Test

As the attorney-client privilege shields those communications made by a client to his attorney,²² an interesting definitional problem immediately arises. A corporation, while an independent legal entity, is a fictional person, and as such, can communicate only through its agents and employees. If the corporate client may be considered to speak through all of its employees and agents, the scope of the privilege would be extended far beyond reasonable bounds. Thus, the relationship between the communicating agent and the corporate client must be analyzed to determine whether the agent is acting for the corporation in its capacity as a client and whether the communicating agent has authority to speak for the corporation in matters touching upon the asserted attorney-client relationship.²³

tions often constitute the controlling factor of different companies with whom business is transacted, a consideration further militating against confidentiality. 207 F. Supp. at 774. Lastly, Judge Campbell, noting that the visitatorial powers of the state weaken the confidential nature of corporate records, declared that "[o]ne of the prices one pays for the limitation of personal liability through incorporation is the loss of personal privileges one might otherwise have in individual business transactions." *Id.* at 775.

¹⁹ *Radiant Burners, Inc. v. American Gas Ass'n*, 320 F.2d 314 (7th Cir.) (en banc), cert. denied, 375 U.S. 929 (1963) rev'g, 207 F. Supp. 771 (N.D. Ill. 1962). In reversing Judge Campbell's decision, the Seventh Circuit noted that corporations have always enjoyed the benefits of the privilege and "[t]he privilege is that of a 'client' without regard to the non-corporate or corporate character of the client . . ." 320 F.2d at 322. It is now clear that "a corporation like any other 'client' is entitled to the attorney-client privilege." *Bell v. Maryland*, 378 U.S. 226, 263 app.I (1964).

²⁰ Simon, *supra* note 3, at 955.

²¹ See notes 28-30 and accompanying text *infra*.

²² The converse is also true: the attorney-client privilege protects communications made in confidence by the attorney to his client. See, e.g., *Natta v. Hogan*, 392 F.2d 686, 692-93 (10th Cir. 1968); *Hesselbine v. von Wedel*, 44 F.R.D. 431, 433 (W.D. Okla. 1968). The privilege also affords protection to communications between the attorney and his representative or agent whose consultation is necessary to protect the client's interests. See, e.g., *United States v. Judson*, 322 F.2d 460, 462 (9th Cir. 1963) (accountant's report privileged).

²³ A balance must be struck, therefore, between two competing interests. If all agents and employees of the corporation were permitted to invoke the privilege on its behalf, the scope of the corporate attorney-client privilege would extend far beyond that allowed to the individ-

The first significant effort to deal with this problem was made in *City of Philadelphia v. Westinghouse Electric Corp.*,²⁴ wherein the court held that only those persons vested with upper level decisionmaking power were entitled to invoke the privilege on behalf of the corporate client. The court's holding, however, was foreshadowed by the Supreme Court's earlier decision in *Hickman v. Taylor*.²⁵

In *Hickman*, the Court refused to extend the cloak of privilege to reports and interviews garnered by an attorney, retained by a partnership of tugboat owners, from the captain and crew of a tug involved in a fatal accident. Treating the employees as mere witnesses or third parties to the accident, the Court apparently gave no significance to the fact that the interviewees were also employees of the client, speaking to the client's attorney concerning matters involving the client's interest.²⁶ Insofar as the employees were not deemed to be spokesmen of the client for purposes of invoking the privilege,²⁷ *Hickman* thereby furnished the *Philadelphia* court

ual client. In contrast, if the corporate entity alone was designated as the client, thereby denominating all its agents and employees as third parties, statements of all corporate agents necessarily would be reduced to an unprivileged status, leaving the corporate client powerless to engage in any type of privileged communication. Inasmuch as the purpose of the privilege, the encouragement of communication between attorney and client, would be defeated, clear delineation of which agents are entitled to speak on behalf of the corporate client is vital to ensure its successful operation.

²⁴ 210 F. Supp. 483 (E.D. Pa.), *mandamus and prohibition denied sub nom.* General Elec. Co. v. Kirkpatrick, 312 F.2d 742 (3d Cir. 1962), *cert. denied*, 372 U.S. 943 (1963).

²⁵ 329 U.S. 495 (1947).

²⁶ *Id.* at 508. In reaching its conclusion, the Court was aware of the conflicting principles embodied in the federal discovery rules. Rule 26, for example, only extends its coverage to those matters "not privileged." FED. R. CIV. P. 26(b). On the other hand, the Court declared liberal discovery demands "[m]utual knowledge of all the relevant facts gathered by both parties [which] is essential to proper litigation." 329 U.S. at 507. Since in *Hickman* the communications made to the attorney were not for the purpose of charting a course of action in the future, but rather "in anticipation of litigation," reliance upon the attorney-client privilege was inapposite. *Id.* at 508. See also Simon, *supra* note 3, at 958.

²⁷ While the *Hickman* Court did not grant privileged status to the attorney's reports, the decision is better known for the qualified immunity from discovery granted to reports, mental impressions, and other writings prepared by an attorney in anticipation of litigation. The Court labelled preparation of this type the attorney's "work product." 329 U.S. at 511. Cognizant of the privacy historically recognized as necessary for counsel to prepare his client's case, the Court ruled that the mental processes of the attorney could not be probed absent exigent circumstances. *Id.*

Thus, discovery of an attorney's work product has been allowed only in circumstances where the opposing party makes a special showing of necessity or justification. See, e.g., *Xerox Corp. v. International Business Mach. Corp.*, 64 F.R.D. 367 (S.D.N.Y. 1974) (substantial need shown where defendant conceals information known only to it under the guise of work product); *Hanson v. Gartland S.S. Co.*, 34 F.R.D. 493 (N.D. Ohio 1964) (allowing discovery of statements of seamen witnesses, who because of nature of occupation could not be located). See generally Note, *Attorney's Work-Product Privilege in the Federal Courts*, 42 ST. JOHN'S L. REV. 560 (1968).

with the basis for its narrow delineation of which employees of the corporate client are entitled to speak on its behalf.

The *Philadelphia* court, while refusing to follow the holding of *Radiant Burners*, nevertheless was mindful of the possible abuses inherent in an overly broad privilege adverted to by Judge Campbell.²⁸ Seizing upon the reasoning of the Supreme Court in *Hickman*,²⁹ the *Philadelphia* court extended the benefits of the attorney-client privilege only to an employee who

is in a position to control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney,

On the other hand, documents not prepared in anticipation of litigation do not constitute the attorney's work product, though they may fall under some other privilege. *See, e.g., United States v. Illinois Fair Plan Ass'n*, 67 F.R.D. 659 (N.D. Ill. 1975) (documents not part of counsel's work product but may not be discoverable because of executive privilege); *Stix Prods., Inc. v. United Merchants & Mfrs., Inc.*, 47 F.R.D. 334, 337 (S.D.N.Y. 1969) (to be considered prepared in anticipation of litigation, documents must be "identifiable because of specific claims that have already arisen. . . .")

²⁸ The *Philadelphia* court, while conceding that the *Radiant Burners* decision was "supported by a good deal of history and sound logic," nevertheless felt constrained to recognize the existence of a corporate attorney-client privilege. The court noted that its existence "has gone unchallenged so long and has been so generally accepted that I must recognize that it does exist." 210 F. Supp. at 484.

²⁹ The court was careful to note that, regardless of the employee's position in the corporate hierarchy, if the communication to the attorney was "relative to pending litigation" it was not privileged. *Id.* at 485. Upon first blush it might seem that the *Philadelphia* court deprived the corporation of the opportunity to assert the attorney-client privilege in this context. It appears, however, that the court raised this point only to distinguish statements of third parties or mere witnesses from those of the corporate client.

In contrast to the *Philadelphia* court's distinction between mere witnesses and privileged agents of the corporate client is an earlier decision in *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357 (D. Mass. 1950). In *United Shoe*, a civil antitrust action, the court held that information furnished to the corporation's attorney from any employee of the corporate client fell within the ambit of the privilege. *Hickman*, the *United Shoe* court declared, came into play only where reports furnished to counsel originated "outside the organization of defendant and its affiliates" *Id.* at 359. Such reports would comprise the attorney's work product and would be discoverable by an adversary upon a showing of good cause. *See* note 27 *supra*.

The distinction between the formulations arrived at in *United Shoe* and the *Philadelphia* court's interpretation of *Hickman* are more than differences in degree. While in certain cases the attorney-client privilege and the work product doctrine produce similar results, *i.e.* non-disclosure of certain attorney-client communications, they have dissimilar theoretical bases. As one court has remarked:

The purpose of the attorney-client privilege is to encourage full disclosure of information between an attorney and his client by guarantying the inviolability of their confidential communications. The "work product of the attorney", on the other hand, is accorded protection for the purpose of preserving our adversary system of litigation by assuring an attorney that his private files shall . . . remain free from the encroachments of opposing counsel.

Scourtes v. Fred W. Albrecht Grocery Co., 15 F.R.D. 55, 58 (N.D. Ohio 1953).

or if he is an authorized member of a body or group which has that authority, then, in effect, he is (or personifies) the corporation when he makes his disclosure to the lawyer and the privilege would apply.³⁰

Utilization of the control group test mandates, then, that only those employees of the corporation who have actual authority to take part in the decisionmaking process be afforded the opportunity to invoke the privilege on behalf of the corporation.³¹ In striving to equate the attorney-client privilege in the corporate context with the privilege involved in purely personal communications made by an individual client to his attorney, the *Philadelphia* court viewed the client as being only those representatives of the corporation who seek legal advice on its behalf; all other employees not vested with this high level of decisionmaking authority are considered mere witnesses or third parties.³²

The attractiveness of the control group test is due, in large part, to the ease of its application and the certainty which necessarily results from the formulation of a "bright-line rule."³³ Unfortunately, the test ignores the dual role of the modern corporate client. To function effectively, a corporation necessarily requires the services of an attorney to guide it through a maze of securities, antitrust, and tax statutes and regulations. Likewise, the corporation requires the services of an attorney to assist it in the prepa-

³⁰ 210 F. Supp. at 485.

³¹ The court was careful to note that mere labels of authority in and of themselves are not sufficient to allow the corporate employee to invoke the privilege. Denominating someone a "manager" without affording him the power that would ordinarily run with the title is not sufficient to permit him to invoke the benefits of the privilege on behalf of the corporation. Conversely, one who does possess power to formulate the business policy of his corporation would be deemed a member of the corporate control group regardless of title. *Id.* at 485-86. Thus, in *Garrison v. General Motors Corp.*, 213 F. Supp. 515 (S.D. Cal. 1963), the court examined the duties of those employees working in the corporation's patent department to determine whether they were entitled to invoke the privilege on behalf of the corporation. The court concluded that "officers, directors, department heads of GMC," including the division manager of a GMC subsidiary, his assistant and chief engineer, were vested with sufficient power to be deemed members of the control group. *Id.* at 518. *See also* *Natta v. Hogan*, 392 F.2d 686 (10th Cir. 1968).

³² Of course, if not a member of the corporate control group, it is possible that the employee's communications could be afforded the more limited protection of the work product doctrine, note 27 *supra*. The protection accorded these communications, however, would be less than complete because they would have to be produced upon a showing of good cause by an adversary.

³³ *See* Note, *Attorney-Client Privilege for Corporate Clients: The Control Group Test*, 84 HARV. L. REV. 424, 430-32 (1970). Further, by drafting a narrow test regarding the availability of the privilege to the corporate client, the amount of material not privileged and therefore discoverable by an adversary is great, thereby augmenting the current trend towards increased pretrial disclosure of information between parties. *See* note 6 and accompanying text *supra*.

ration of a defense when charged with violation of the law.³⁴ In the case of an individual client, communications made to the attorney in both contexts would fall within the ambit of the privilege. The corporate client, however, would receive the benefits of the privilege under this test only if the top echelon of the decisionmaking group were involved in the attorney-client communications.

Such an anomalous result ignores the realities of modern corporate decisionmaking, in which top level management does not necessarily make the day-to-day decisions which allow the corporation to remain a viable force in the marketplace.³⁵ It must be assumed that any consultation between a corporate decisionmaker and an attorney is for the purpose of keeping corporate activities within the law. To permit discovery of the options presented by counsel to lower level management, while shielding those opinions rendered to persons within a narrowly drawn corporate control group, necessarily discourages those not members of the control group from seeking legal advice from the corporation's attorneys.³⁶ As one commentator has remarked, "[i]t would better serve the interests of society to encourage a desire for legal advice at whatever level that desire exists within a corporation."³⁷

The Subject Matter Test

Aware of the harshness and inequitable consequences which result from the mechanical application of the control group test, the Court of Appeals for the Seventh Circuit, in 1970, formulated new criteria for ascertaining which employees can speak on behalf of the corporate client and yet have their communications retain their privileged character. In *Harper*

³⁴ See note 39 *infra*. See also Burnham, *The Attorney-Client Privilege in the Corporate Arena*, 24 Bus. Law. 901, 913-14 (1969).

³⁵ For decisionmaking purposes, the corporation's board of directors is responsible for originating the business policies of the corporation and officers elected by the board are entrusted with the management of the day-to-day affairs of the corporation, within the guidelines set by the board. See generally H. BALLANTINE, *CORPORATIONS* 119-20 (rev. ed. 1946). It would be a mistake to assume, however, that top level management, whose communications fall within the ambit of the privilege, are involved in such day-to-day considerations as the hiring and discharging of employees or the selection of suppliers. Cf. Simon, *supra* note 3, at 963-66.

³⁶ It must be borne in mind that the primary purpose of the attorney-client privilege is to facilitate communications between attorney and client by ensuring that they remain confidential. See notes 3-5 and accompanying text *supra*. The corporation, in its role as client, necessarily requires the same unrestricted flow of information between itself and counsel as does the individual client. Hence, regardless of the level within the decisionmaking group from which the communication originates, the privilege should function "as an encouragement to all, strong and weak alike, to consult freely with counsel." Simon, *supra* note 3, at 955.

³⁷ Kobak, *The Uneven Application of the Attorney-Client Privilege to Corporations in the Federal Courts*, 6 GA. L. REV. 339, 368 (1972).

& Row Publishers, Inc. v. Decker,³⁸ a private antitrust action, plaintiffs sought discovery of memoranda drafted by defendant's attorneys pursuant to their debriefing of corporate employees after grand jury appearances. Since the employees from whom the statements were taken were not members of the rigidly defined corporate control group, the district court held the communications were not privileged and ordered their production.³⁹

On mandamus, the Seventh Circuit vacated the order of the district court, concluding that the control group test was "not wholly adequate."⁴⁰ In its stead, the *Harper & Row* court developed a new test, designed to extend the benefits of the attorney-client privilege to a larger class of employees. Pursuant to this test, the employee,

though not a member of [the corporation's] control group, is sufficiently identified with the corporation so that his communication to the corporation's attorney is privileged where the employee makes the communication at the direction of his superiors in the corporation and where the subject upon which the attorney's advice is sought by the corporation and dealt with in the communication is the performance by the employee of the duties of his employment.⁴¹

Thus, regardless of the employee's position in the corporate hierarchy, as long as the corporate employee is speaking to the attorney regarding matters involved in his duties as an employee, the conversation will be deemed privileged and immune from discovery.

Nevertheless, the court was careful to distinguish between those matters in which the employee was acting within the scope of his employment, and those in which the employee was communicating to the attorney as a mere bystander witness. Such events would fall under the rule articulated

³⁸ 423 F.2d 487 (7th Cir. 1970) (per curiam), *aff'd per curiam by an equally divided Court*, 400 U.S. 348 (1971).

³⁹ *Illinois v. Harper & Row Publishers, Inc.*, 50 F.R.D. 37 (N.D. Ill. 1969) (mem.), *rev'd per curiam sub nom. Harper & Row Publishers, Inc. v. Decker*, 423 F.2d 487 (7th Cir. 1970), *aff'd per curiam by an equally divided Court*, 400 U.S. 348 (1971). The district court ruled that defendant's sales executives and district managers, although responsible for the pricing considerations in issue, were not members of the corporate control group for purposes of the instant litigation. The court's reasoning clearly illustrates the dual nature of the corporate client: While declining to express an opinion as to whether the employees would be considered members of the control group with respect to their pricing decisions, the court did express the opinion that they were not deemed members of the control group with respect to their activities aiding the corporation in the preparation of its defense, *i.e.*, "the company's litigation response to the price fixing cases." 50 F.R.D. at 44.

⁴⁰ 423 F.2d at 491. Noting that the district court's application of the control group test was correct, the Seventh Circuit was nevertheless aware of the inherent inequity which would result from allowing discovery of communications made to counsel at the direction of the corporate client and whose "subject matter . . . was germane to the duties of his employment." *Id.*

⁴¹ *Id.* at 491-92.

in *Hickman v. Taylor*, and therefore, would be discoverable by an adversary.⁴² By rejecting the restrictive confines of the control group test, while at the same time paying lip service to the unprivileged status of mere witnesses, the *Harper & Row* court was able to formulate a test which more closely conforms to the realities of modern corporate decisionmaking.⁴³

The test formulated in *Harper & Row*, however, does have one glaring fault. In supplanting the bright-line rule of the control group test, the Seventh Circuit failed to articulate any discernable guidelines for determining whether an employee is within the confines of the attorney-client privilege.⁴⁴ In excluding mere witnesses as a class to whom the privilege is available, without giving an indication of how the term should be defined and distinguished from past application in cases such as *Hickman* or *Philadelphia*, the certainty necessary for uniform application of the privilege is lacking.⁴⁵ After *Harper & Row* attorneys interviewing a corporate

⁴² This result would seem to be compelled not only by *Hickman*, but also by virtue of a decision rendered by the Seventh Circuit 1 year prior to its decision in *Harper & Row*. In *Rucker v. Wabash R.R.*, 418 F.2d 146 (7th Cir. 1969), a personal injury action resulting from a collision between an automobile and a train, the Seventh Circuit panel refused to allow the railroad to assert the privilege for statements made by the train crew to private investigators, noting that, "[n]one were of such rank as to qualify as representative of the corporate client." *Id.* at 154. Clearly, such situations would not fall within the ambit of the attorney-client privilege regardless of which test is utilized, since employees who by mere happenstance witness an accident are, in all cases, merely third parties to the litigation.

⁴³ The subject matter test formulated in *Harper & Row* closely conforms to that utilized by California courts. See, e.g., *D.I. Chadbourne, Inc. v. Superior Court*, 60 Cal. 2d 723, 388 P.2d 700, 36 Cal. Rptr. 468 (1964). In *Chadbourne*, the California Supreme Court developed its own criteria for ascertaining which corporate employees are entitled to speak on behalf of the corporation for the purpose of invoking the attorney-client privilege. The court listed eleven considerations to assist in that determination. In distinguishing corporate employees who are entitled to invoke the privilege on behalf of the corporation from mere witnesses, the court hinged the availability of the privilege on whether the employee's "statement contained any material or information which could not have been known to a nonemployee witness. . . ." *Id.* at 738, 388 P.2d at 710, 36 Cal. Rptr. at 478. *Chadbourne* has been termed a more precise determination of this question than *Harper & Row*, but one which remains difficult to apply. Note, *Attorney-Client Privilege for Corporate Clients: The Control Group Test*, 84 HARV. L. REV. 424, 433 n.29 (1970).

⁴⁴ Apparently, application of the subject matter test requires a two-step determination. First, the employee must furnish the attorney information which he has acquired from the exercise of his duties of employment. 423 F.2d at 490-91. Second, the method by which the employee became aware of the information must be consistent with the employment relationship; the information cannot have been gleaned in the employee's individual capacity. Although these determinations would presumably be made in accord with normal agency concepts, a clear definition of duties of employment is difficult. See generally RESTATEMENT (SECOND) OF AGENCY § 229 (1958).

⁴⁵ The control group test treats those employees not vested with high decisionmaking authority as third parties to the attorney-client relationship. The subject matter test, on the other hand, envisages protection for communications by those employees who have acquired information during the course of their employment, but excludes from its scope declarations by

employee will not know in advance whether the conversation will be subject to discovery.⁴⁶ On the other hand, by leaving the delineation of the subject matter test to future judicial interpretation, the decision may result in expansion of the scope of the attorney-client privilege far beyond its intended limitations.⁴⁷

It must be borne in mind that as the attorney-client privilege constitutes a recognized exception to the liberal atmosphere of discovery in the federal courts, its boundaries must be strictly circumscribed.⁴⁸ Whereas application of a rigidly defined control group test may impede corporate communication, utilization of a vaguely defined subject matter test, as espoused in *Harper & Row*, may require case-by-case determination of the status of employee's communications, thus rendering its application unworkable in the corporate arena. What is necessary to remedy this difficulty is a consistent and universally accepted privilege in the corporate context which will encourage corporations to seek the legal advice of counsel, and yet, at the same time, will not extend beyond reasonable bounds the "zone of silence" which the privilege engenders.

The Expanded Control Group Test

The only federal courts which have utilized the subject matter test enunciated in *Harper & Row* have been located within the Seventh Circuit.⁴⁹ While some courts have consistently adhered to the rigid application of the control group test,⁵⁰ others have felt the harshness of the test inappropriate and have formulated criteria of their own.⁵¹

these same persons should they be mere witnesses. Due to the ambiguity of the definition of a bystander witness in *Harper & Row*, future courts may treat an employee not a member of the control group as a mere witness, thereby rendering the subject matter test impotent in the corporate arena.

⁴⁶ See, e.g., Kobak, *The Uneven Application of the Attorney-Client Privilege to Corporations in the Federal Courts*, 6 GA. L. REV. 339, 367 (1972).

⁴⁷ It is important to note that public policy necessitates that the privilege shield only those communications vital for the corporate client's protection. As one commentator has remarked: "Where corporations are involved, with their large number of agents, masses of documents, and frequent dealings with lawyers, the zone of silence grows [perhaps unnecessarily] large." Simon, *supra* note 3, at 955.

⁴⁸ See note 6 and accompanying text *supra*.

⁴⁹ See, e.g., *Sylgab Steel & Wire Corp. v. Imoco-Gateway Corp.*, 62 F.R.D. 454 (N.D. Ill. 1974) (mem.), *aff'd without opinion*, 534 F.2d 330 (7th Cir. 1976); *Rockwell Mfg. Co. v. Chicago Pneumatic Tool Co.*, 57 F.R.D. 111 (N.D. Ill. 1972) (mem.).

⁵⁰ See, e.g., *Virginia Elec. & Power Co. v. Sun Shipbuilding & Drydock Co.*, 68 F.R.D. 397 (E.D. Va. 1975) (subject matter test runs afoul of liberal discovery atmosphere); *Burlington Indus. v. Exxon Corp.*, 65 F.R.D. 26 (D. Md. 1974); *Honeywell, Inc. v. Piper Aircraft Corp.*, 50 F.R.D. 117, 120 n.1 (M.D. Pa. 1970) (impossible to determine whether employees acting within scope of employment).

⁵¹ See, e.g., *Eutectic Corp. v. Metco, Inc.*, 61 F.R.D. 35 (E.D.N.Y. 1973) (mem.). In *Eutectic*

Perhaps the best method yet advanced to ascertain which employees are entitled to speak on behalf of the corporate client was announced in *Duplan Corp. v. Deering-Milliken, Inc.*⁵² In that multidistrict patent and antitrust action, Judge Hemphill took a "common sense look at the practicalities of the 'control group' test and its applicability in the day-to-day workings of a lawyer,"⁵³ and developed a two-part test combining elements of both the control group and the subject matter tests.

Realizing that a narrow definition of the corporate control groups, such as formulated by the *Philadelphia* court, is not suited to the workings of a modern corporation,⁵⁴ the court first expanded its scope. For the attorney-client privilege to attach, according to the *Duplan* court, the communication must first be directed to or from a member of the corporate control group⁵⁵ or an employee acting at the behest of one of its members. Thus, no simple definition of whom the communication must be from is possible, since "the main consideration is whether the particular representative of the client . . . is involved in . . . the decisionmaking process concerning a problem on which legal advice is sought."⁵⁶

The second phase of the *Duplan* test is more precise. If the communication was from a member of the control group or one acting at

Corp., a patent infringement action, the court declined to formulate a new test regarding which corporate employees could claim the protection of the privilege. Instead, the court looked to a number of factors in ascertaining whether the employees involved had acted as representatives of the client, "including but not limited to: the nature and content of the communications, the extent of their disclosure within the corporation, and the relationship of the employees involved to the communication and to the corporation. . . ." *Id.* at 40. In upholding the defendant's claim of privilege, the *Eutectic* court apparently followed the reasoning of *Harper & Row*. It was, however, careful to note that its decision was confined solely to the facts and circumstances of the case before it. *Id.* The *Eutectic* decision, while having little precedential value, can nevertheless be considered evidence of at least one court's desire to break away from an objective application of the control group test.

⁵² 397 F. Supp. 1146 (D.S.C. 1974).

⁵³ *Id.* at 1164.

⁵⁴ In commenting upon the necessity that the corporate control group be enlarged, the *Duplan* court declared:

There has to be a sufficient number of persons within a corporation who are authorized on behalf of the corporation to seek advice, to give information with respect to the rendition of advice, and to receive advice. A corporate system would break down if such were not permissible.

If only one, two, three, or four persons within a corporate structure could be the corporation when it must seek legal advice, then, for all practical purposes, any corporation would not have an effective attorney-client privilege. The chairman of the board and other top executives necessarily have more important matters to attend to than gathering information. . . .

Id.

⁵⁵ *Id.* at 1163.

⁵⁶ *Id.* at 1165.

his direction the court will then apply the subject matter test and focus upon whether "[t]he communication [was] incident to a request for the rendition of legal advice."⁵⁷ When both criteria are met, the communication will be deemed privileged and immune from discovery.

Thus, instead of hinging the availability of the attorney-client privilege on the employee's merely being engaged in the duties of his employment, as in *Harper & Row*, or being a member of a small corporate control group, as in *Philadelphia*, *Duplan* extends the privilege to those employees actually involved in formulating the business policy of the corporation. Further, there is no need to engage in time consuming and subjective considerations to determine whether the employee involved was a mere witness or was acting in the scope of his employment.⁵⁸ The needs of the corporation, functioning in its dual role as a client, are then served in much the same way as those of the individual client. Communications, whether they be from one seeking advice as to the course of conduct to be pursued in the future or from one supplying information to counsel regarding impending litigation, are privileged if they originate from a member of this "expanded control group."⁵⁹

It is submitted that the expanded control group test of *Duplan* is preferable, due to its increased certainty and in its advancement of the policies underlying the existence of the attorney-client privilege, to either of the earlier formulations. The ability to control or substantially affect the corporation's business policy, which is the thrust of the control group test, has been retained and expanded to reflect the realities of modern corporate decisionmaking. Thus, certainty and ease of application, one of the attributes cited by supporters of the control group test, is maintained. The corporate attorney, who must plot his course of action based upon the availability of the privilege, is also furnished with discernable guidelines. A case-by-case resolution of the problem can thus be avoided, while the number of employees deemed to be representing the corporate client will be limited to a well-defined group.

⁵⁷ *Id.*

⁵⁸ See note 59 *infra*.

⁵⁹ Problems may arise, however, in ascertaining whether an employee is acting under the direction of a member of the corporate control group for purposes of invoking the attorney-client privilege. It is submitted that utilization of the expanded control group test as set forth in *Duplan* extends the privilege to those under a general grant of authority by a member of the control group. Thus, an employee such as a regional office manager under instructions from the board of directors to "maximize corporate profits" would be able to use the independent authority granted him by the control group and still fall within the ambit of the privilege. For an examination and analysis of another proposed test which closely resembles that of *Duplan*, see Note, *The Attorney-Client Privilege in the Corporate Setting: A Suggested Approach*, 69 MICH. L. REV. 360, 379 (1970). See also Comment, *The Privileged Few: The Attorney-Client Privilege as Applied to Corporations*, 20 U.C.L.A. L. REV. 288 (1972).

EXCEPTIONS TO THE PRIVILEGE

In certain factual situations, although the communications to an attorney meet the normal requirements for a claim to privilege, the privilege does not attach. One such situation has been labeled the prospective crime or fraud exception. Briefly, this doctrine states that any communications made by a client to his attorney concerning prospective illegal activities does not involve the professional relationship between the parties, and thus vitiates the confidentiality of the communications.⁶⁰

Another well-recognized exception to the attorney-client privilege arises in situations in which the same attorney serves in his capacity as such⁶¹ for two different clients who later find themselves opposing each other in litigation. According to Wigmore, communications from one client to the joint attorney, "are not privileged in a controversy between the two original parties, inasmuch as the common interest and employment forbade concealment by either from the other."⁶² The rationale for such a rule is clear: an attorney acting as agent for two clients cannot prevent one client from obtaining information regarding whether the attorney has permitted one client's interest to predominate over the other's.⁶³ It should be noted, however, that insofar as third parties are concerned, the communications retain their privileged nature.⁶⁴

The exception has enjoyed wide popularity in the insured-insurer context. In the majority of instances, the joint attorney exception arises in suits brought against an insurer by an insured claiming bad faith or negligence in the handling of his claim.⁶⁵ Thus, expeditious settlement of the

⁶⁰ See generally 8 WIGMORE, *supra* note 1, §§ 2298-99, at 572-80. The touchstone for the vitiation of a privilege in this context is *Clark v. United States*, 289 U.S. 1 (1932), discussed in notes 67-68 and accompanying text *infra*. The Court indicated in *Clark* that if evidence is presented which gives color to the charge that the client has engaged in or seeks legal advice for the purpose of engaging in future criminal or fraudulent activity, an evidentiary privilege will be defeated. *Id.* at 13-16.

⁶¹ It is interesting to note that bar membership, in and of itself, is not sufficient to allow the client to assert that his communications with counsel fall within the ambit of the privilege. Intercourse with counsel must deal primarily with legal advice arising out of the attorney-client relationship in order for the privilege to attach. Thus, in *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 360 (D. Mass. 1950), the court refused to extend the privilege to communications from persons functioning primarily as patent agents, notwithstanding prior legal education or bar membership, noting: "Grist which comes to their mill has a higher percentage of business content than legal content." *Accord*, *Lowy v. Commissioner*, 262 F.2d 809 (2d Cir. 1959) (attorney acting as business associate); *United States v. Vehicular Parking, Ltd.*, 52 F. Supp. 751 (D. Del. 1943) (attorney serving as business negotiator); *In re Fisher*, 51 F.2d 424 (S.D.N.Y. 1931) (attorney serving as bankrupt's accountant).

⁶² 8 WIGMORE, *supra* note 1, § 2312, at 603-04.

⁶³ See, e.g., *Shapiro v. Allstate Ins. Co.*, 44 F.R.D. 429, 431 (E.D. Pa. 1968) (mem.).

⁶⁴ See, e.g., *Grand Trunk W.R.R. v. H.W. Nelson Co.*, 116 F.2d 823, 835 (6th Cir. 1941).

⁶⁵ Parties to an insurance contract are normally said to be in a debtor-creditor relationship.

litigation hinges upon the tripartite communications between attorney, insurer, and insured. Accordingly, courts do not permit the insurer to invoke the attorney-client privilege, since both parties in the suit necessarily had to communicate to the same attorney in order to pursue their interests.⁶⁶

ROLE OF THE PRIVILEGE IN SHAREHOLDER SUITS

In situations in which the potential injury resulting from nondisclosure of relevant information conflicts with the probable benefits of divulgence of these heretofore privileged communications, these interests must be balanced. The classic pronouncement of the test employed in such situations, in an analogous context, was voiced by Justice Cardozo in *Clark v. United States*.⁶⁷

[R]ecognition of a privilege does not mean that it is without conditions or exceptions. The social policy that will prevail in many situations may run foul in others of a different social policy, competing for supremacy. It is then the function of a court to mediate between them, assigning, so far as possible, a proper value to each, and summoning to its aid all the distinctions and analogies that are the tools of the judicial process.⁶⁸

In handling a claim of the insured, however, the status of the parties changes so that the insurer is placed in a relationship of "trust and confidence" with the insured, thus mandating that a good faith effort be expended by the insurer in the settlement of the claim. 3 G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 23:11, at 11-13 (2d ed. 1960).

⁶⁶ See, e.g., *LaRocca v. State Farm Mut. Auto. Ins. Co.*, 47 F.R.D. 278 (W.D. Pa. 1969); *Shapiro v. Allstate Ins. Co.*, 44 F.R.D. 429 (E.D. Pa. 1968) (mem.); *Chitty v. State Farm Mut. Auto. Ins. Co.*, 36 F.R.D. 37 (E.D.S.C. 1964).

⁶⁷ 289 U.S. 1 (1932).

⁶⁸ *Id.* at 13. In *Clark*, the Court was called upon to balance the common law privilege accorded jury considerations and balloting against disclosure for the purpose of showing active concealment by a juror during the *voir dire* examination. Recognizing that "[f]reedom of debate might be stifled and independence of thought checked if jurors were made to feel that their arguments and ballots were to be freely published to the world," the Court nevertheless held that active concealment on the part of a juror vitiates the privilege. *Id.* at 13, 18-19.

The reasoning of *Clark* has since been applied in various situations wherein the existence of an evidentiary privilege conflicts with some higher social value. Thus, in *United States v. Bartlett*, 449 F.2d 700 (8th Cir. 1971), *cert. denied*, 405 U.S. 932 (1972), an attorney who was a member of a law firm representing the Arkansas Loan & Thrift Co. and who had attended the directors' meeting of the company was permitted to testify in a securities fraud prosecution against the chief executive officer of the company notwithstanding the purported existence of the attorney-client privilege. *Accord*, *United States v. Bob*, 106 F.2d 37 (2d Cir.), *cert. denied*, 308 U.S. 589 (1939); *cf.* *Meyerhofer v. Empire Fire & Marine Ins. Co.*, 497 F.2d 1190 (2d Cir.), *cert. denied*, 419 U.S. 998 (1974) (attorney-client privilege inapplicable where attorney deposes as to own noninvolvement in alleged securities fraud). See also *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

Fiduciary Duty of Directors, Officers, and Controlling Shareholders

It is a well-established principle of corporate law that one who controls the affairs of a corporation or is responsible for the formulation of corporate policy owes a fiduciary duty to that corporation and its shareholders.⁶⁹ Thus, officers,⁷⁰ directors,⁷¹ and controlling shareholders⁷² are charged with a high degree of care since they are dealing with the interests of the shareholders and the corporation. The extent of and applicable standards for these fiduciary duties have given rise to much litigation; indeed, one court has noted: "[T]he doctrine of the fiduciary relation is one of the most confused and entangled subjects in corporation law."⁷³

In the earlier cases, a director or controlling shareholder of a corporation occupying this fiduciary relationship frequently was denominated a trustee and held accountable as such in equity.⁷⁴ The basis for this trust relationship was that directors are charged with the guidance of the corporation's business policy and control of its assets, and therefore, are respon-

⁶⁹ See generally, 3 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 838, at 142-44 (perm. ed. 1975) [hereinafter cited as FLETCHER]; 1 G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 432 (1959).

⁷⁰ See, e.g., *Woodson v. McAllister*, 121 F.2d 126, 129 (5th Cir. 1941) (when corporate officers bargain between themselves for corporate property, shareholder interests must be considered).

⁷¹ See, e.g., *Pepper v. Litton*, 308 U.S. 295, 306 (1939); *Twin-Lick Oil Co. v. Marbury*, 91 U.S. (1 Otto) 587, 588 (1875); *Koehler v. Black River Falls Iron Co.*, 67 U.S. (2 Black) 715, 719 (1862).

⁷² See, e.g., *Mount v. Seagrave Corp.*, 112 F. Supp. 330 (S.D. Ohio 1953), *aff'd*, 212 F.2d 389 (6th Cir. 1954), wherein the court held that by virtue of their dominion and control of the corporation and their representation by four of its seven directors, the controlling shareholders were fiduciaries, exercising powers in trust for the corporation and the minority shareholders.

⁷³ *Geller v. Transamerica Corp.*, 53 F. Supp. 625, 629 (D. Del. 1943).

⁷⁴ See, e.g., *Ervin v. Oregon Ry. & Nav. Co.*, 27 F. 625 (S.D.N.Y. 1886). There, the majority shareholder of a steamship company contracted with a promoter to sell the controlling shares in exchange for cash plus shares to be issued by the new corporation. Upon formation, the new corporation assumed the contract of its promoter and made an offer to purchase the property of the old company which was accepted by its board of directors. The purchase price, which was less than the fair market value, was justified by the directors on the assumption that the sale was advantageous under the circumstances since a new railroad to be constructed by the company would soon deplete existing steamship traffic. In resolving the question before it, the court stated:

[Directors and controlling shareholders] become for all practical purposes the corporation itself, and assume the trust relation occupied by the corporation towards its stockholders. . . . The corporation itself holds its property as a trust fund for the stockholders . . . and the relation between it and its several members is, for all practical purposes, that of trustee and *cestui que trust*.

Id. at 631. Using this high standard of care, the court held that in dealing for themselves, seeking profit at the expense of the minority, the majority shareholders were "guilty, at least, of constructive fraud." *Id.* at 632.

sible for the property interests of the shareholders. Thus, these interests were deemed to be infused through the corporation to the directors, resulting in the creation of a trusteeship with its concomitant fiduciary duties.⁷⁵

As both corporate size and sophistication grew, however, the analogy between directors and trustees proved to be unduly burdensome. Legal distinctions between trustees and directors became apparent;⁷⁶ yet directors have remained under a general fiduciary duty to deal fairly and in good faith.⁷⁷ Whether a director is considered a trustee, fiduciary, or agent, his acts affect the interests of the shareholders, and, consequently, his dealings must be subjected to close scrutiny. As one court has noted, "when all is said and done management is not managing for itself," therefore, its "judgment must stand on its merits, not behind an iron-clad veil of secrecy which . . . preserves it from being questioned by those for whom it is, at least in part, exercised."⁷⁸

The English Experience

Under English law, it appears that the relationship of director and shareholder is treated as one between trustee and *cestui que trust*. Therefore, English courts have analogized suits by corporate shareholders against their directors to suits by trust beneficiaries against their trustees. The English cases, relying primarily upon trust principles,⁷⁹ do not recog-

⁷⁵ See *id.*; cf. *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

⁷⁶ Corporate directors, unlike trustees, do not hold legal title to the property entrusted to them; they act under a general grant of power whereas a trustee's authority is strictly limited to the terms of the trust. Moreover, in the usual course of business, a majority of the directors may bind the corporation; actions by joint trustees, however, must be unanimous. G. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 16, at 94-98 (2d ed. 1965); *Bosworth v. Allen*, 168 N.Y. 157, 164, 61 N.E. 163, 164 (1901).

⁷⁷ See, e.g., *United States v. Gates*, 376 F.2d 65, 77 (10th Cir. 1967) (directors are trustees in a limited sense, occupying fiduciary relationship with corporation and shareholders); 3 FLETCHER, *supra* note 69, § 838, at 142. Nevertheless, there is still relatively modern support for the director-trustee analogy. See Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932). But see Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

⁷⁸ *Garner v. Wolfinbarger*, 430 F.2d 1093, 1101 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

⁷⁹ The English trust cases do not recognize the attorney-client privilege in situations where the *cestui que trust* is the opponent and is seeking opinions of counsel rendered to the trustee before the institution of the litigation paid for out of trust funds. See G. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 961, at 9 (2d ed. 1965); *In re Mason*, [1883] 22 Ch. D. 609 (communications by trustee to counsel regarding trust matters before litigation instituted not privileged). The most recent reaffirmation of the English principle was voiced in *In re Londonderry's Settlement*, [1964] 3 All E.R. 855, 863 (C.A.), wherein the court stated that "[i]f the documents in question are in the possession or powers of the trustees and are relevant to the issues in the action, they must be disclosed whether or not they are trust documents." The rationale behind this principle was succinctly stated by the court: "[T]he beneficiaries have a proprietary interest in the documents and, accordingly, are entitled to see them." *Id.*

nize the privilege between attorney and client in cases wherein the legal advice sought to be discovered was obtained before the present litigation was contemplated and was paid for out of corporate assets.⁸⁰ Curiously, however, this principle does not seem to apply in cases in which the corporation has instituted an action against one of its shareholders, notwithstanding the fact that the opinion of counsel has similarly been paid for out of corporate funds.⁸¹

The American Experience

Unlike the English decisions, which recognize that a trustee cannot withhold relevant information from his beneficiary regardless of its privileged character, American courts have reached the opposite result. In *In re Prudence Bonds Corp.*,⁸² holders of certain corporate bonds subject to a trust indenture sought the production of opinions of counsel furnished to the bond trustee during the administration of the trust and prior to the advent of litigation. The court specifically declined to follow the reasoning of the English decisions.⁸³ Utilizing a balancing approach in which it weighed the benefit to the plaintiff bondholders against the harm which would result to the trustee from permitting disclosure of the communications, the court concluded that the privileged status of the reports rendered them immune from discovery. It was the opinion of the court that the trustee should be free to seek legal advice and act according to his judgment aided by the opinion of counsel and uninfluenced by fear of disclosure.⁸⁴

⁸⁰ *Gouraud v. Edison Gower Bell Tel. Co.*, 57 L.J. Ch. 498 (1888). The court in *Gouraud* declared:

[I]n actions by a *cestui que trust* against a trustee . . . a party cannot resist production of documents which have been obtained by means of payments from the moneys belonging to the party applying for their production. I think that this is the general principle, and one which, to my mind, applies as between a shareholder and the directors who manage his property, when the documents are paid for out of his property.

Id. at 499-500. *Accord*, *Dennis & Sons, Ltd. v. West Norfolk Farmers' Manure & Chem. Co-Operative Co.*, [1943] 2 All E.R. 94 (Ch.).

⁸¹ *Woodhouse & Co. v. Woodhouse*, 30 T.L.R. 559 (1914).

⁸² 76 F. Supp. 643 (E.D.N.Y. 1948), *aff'd on other grounds sub nom. Prudence-Bonds Corp. v. Prudence Realization*, 174 F.2d 288 (2d Cir. 1949).

⁸³ 76 F. Supp. at 646.

⁸⁴ Thus, the court concluded:

Where we have a corporate trustee, the rights involved are not alone the rights of a bondholder but of all parties to the Trust Agreement. . . . Where we are dealing only with opinions and legal advice of counsel, the court cannot and should not close its eyes, solely because of the interest of bondholders, to the other important right of such a corporate trustee, with its large responsibility, . . . without being influenced by fear that in some subsequent litigation such opinions or advice so rendered, may be gener-

A particularly acute problem arises in suits in which the corporate client is the defendant in an action brought by one of its shareholders.⁸⁵ In such cases, before granting discovery of communications alleged to be privileged, the court must balance the shareholder's need in ascertaining management's considerations utilized in pursuing a course of conduct which may be inimical to their interests with, *inter alia*, the necessity that the corporation be able to conduct its business free from vexatious interference by a dissident few.

Garner v. Wolfinbarger

The decision which resolved the conflict between these competing interests was *Garner v. Wolfinbarger*,⁸⁶ wherein the Court of Appeals for the Fifth Circuit held that upon a showing of "good cause"⁸⁷ by plaintiff shareholders, communications of their corporation are discoverable, notwithstanding the fact that such communications were made within the context of the privileged attorney-client relationship. In so holding, the court developed a flexible rule, which, if properly applied within its narrow boundaries, represents a major step forward in protecting the rights of shareholders whose interests have been adversely affected.⁸⁸

In *Garner*, shareholders of the First American Life Insurance Co. of Alabama (FAL) instituted a class action against the company alleging violations of federal and state securities laws, as well as common law fraud. During pretrial deposition, questions were asked of FAL's former attorney relating to communications between the attorney and the directors of FAL concerning the issuance and sale of certain stock. FAL objected to these interrogatories, contending the communications were protected by the attorney-client privilege. Upon motions to require the attorney to answer the questions, the district court ruled that the privilege was unavailable to FAL against the plaintiff shareholders.⁸⁹ The court held that English

ally gone over with a biased eye and bring him before a court to explain why he gave same.

Id. at 646-47. *Accord*, *Arney v. George A. Hormel & Co.*, 53 F.R.D. 179 (D. Minn. 1971) (mem.) (communications from attorney to settlor of corporate pension plan privileged); *In re Scranton Corp.*, 37 F.R.D. 465 (M.D. Pa. 1965) (attorney's memorandum to cotrustees in bankruptcy privileged as to bankrupt's creditors).

⁸⁵ *Cf.* *Radiant Burners, Inc. v. American Gas Ass'n*, 207 F. Supp. 771, 774-75 (N.D. Ill. 1962); *Simon*, *supra* note 3, at 966-69.

⁸⁶ 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

⁸⁷ 430 F.2d at 1104.

⁸⁸ See notes 96-103 and accompanying text *infra*.

⁸⁹ *Garner v. Wolfinbarger*, 280 F. Supp. 1018 (N.D. Ala. 1968), *vacated and remanded*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971). For a criticism of the district court's ruling, see Comment, *The Attorney-Client Privilege in Shareholder's Suits*, 69 COLUM. L. REV. 309 (1969).

common law, incorporated into the law of Alabama,⁹⁰ did not extend the attorney-client privilege to a corporation in suits against it by its shareholders.⁹¹

The Fifth Circuit vacated and remanded,⁹² declining to formulate any black letter rubric regarding the availability of the privilege in shareholder suits. Balancing the "interests between injury resulting from disclosure and the benefit gained in the correct disposal of litigation,"⁹³ the court framed the issue in the context of the "particularized contest" at hand.⁹⁴ Accordingly, in the instant case, in which the client seeking to assert the privilege was deemed by law to be acting in the interest of those against whom the privilege is claimed,⁹⁵ a reexamination of the factors that have traditionally determined the availability of the privilege was thought to be mandated. If, after an examination of these factors, the harm of disclosure is outweighed by the benefits to be obtained by the shareholders, the privilege should fail. The court labeled the factors that would defeat a claim of privilege "good cause."

The Balancing Approach

The *Garner* court's conception of good cause arises out of the "particularized context" of the corporation-shareholder relationship. Thus, unlike cases in which unrelated litigants are seeking discovery of privileged communications, different considerations necessarily apply where the parties are linked by fiduciary duties. In such cases, the court must balance the interests of the respective parties, at all times remaining cognizant of the abuses which would result from either an unequivocal denial of the privilege on the one hand, or an absolute bar of the shareholders' right of discovery on the other.⁹⁶

A right of unrestricted access to privileged communications by the shareholder presents a grave threat to the effective functioning of the corporation. For example, there may be times where, at first blush, it appears

⁹⁰ In the course of its opinion, the district court noted that there had been no American decision to date dealing with the question before it. Accordingly, the court applied the Alabama reception statute, ALA. CODE tit. 1, § 3 (1960), and utilized the English law of privilege for the basis of its holding.

⁹¹ 280 F. Supp. at 1019; *accord*, *Fischer v. Wolfenbarger*, 45 F.R.D. 510 (W.D. Ky. 1968). For a discussion of the English cases, see notes 79-81 and accompanying text *supra*.

⁹² 430 F.2d at 1104. On remand, the district court ruled that FAL could not assert the privilege, declaring that "[n]o officer, controlling stockholder, attorney or creditor of the corporation is entitled to conceal from the plaintiff stockholders whatever the facts [in issue] may be." *Garner v. Wolfenbarger*, 56 F.R.D. 499, 504 (S.D. Ala. 1972).

⁹³ 430 F.2d at 1101.

⁹⁴ *Id.*

⁹⁵ See notes 69-78 and accompanying text *supra*.

⁹⁶ See note 68 *supra*.

that management is acting adversely to the shareholders' interest, while upon closer examination it is clear that they are not.⁹⁷ Furthermore, the threat of unwarranted and vexatious suits⁹⁸ increases as curious shareholders are given the right to inspect privileged corporate communications. In fact, one commentator submits that, in most cases, shareholders in a derivative or class action actually do not represent the interests of the majority of shareholders; hence, disclosure of privileged communications would outweigh any benefits which might be derived by the corporation.⁹⁹

The existence of a blanket privilege for all communications by corporate management, however, is equally undesirable.¹⁰⁰ Shareholders, it must be remembered, are the true owners of the corporation. Thus, logic dictates they should be permitted to inspect the documents of their agents (management) who may have acted inimically to their interests. Furthermore, the sheer size of many modern corporations sometimes militates against a shareholder obtaining information relating to the workings of his company.¹⁰¹ Refusing these shareholders the right to inspect documents because of their privileged character can give management an undue advantage against a shareholder prosecuting a viable claim.

The *Garner* court struck a new balance between these competing interests, hinging the availability of the attorney-client privilege upon "the right of the stockholders to show cause why it should not be invoked in the

⁹⁷ Such a situation might occur where a target corporation purposely decreases its liquidity by applying its assets to capital improvement or increases the corporate debt through investment in order to thwart an attempted takeover bid by tender offer. See 2 B. Fox & E. Fox, *CORPORATE ACQUISITIONS & MERGERS*, § 27.07[1], at 27-114 (1975). Although these tactics ultimately may prove profitable for the target company, an individual shareholder ignorant of such defensive maneuvers might object. If the dissident shareholder, without showing that the alleged corporate action constitutes legally cognizable harm, is permitted to destroy the corporation's attorney-client privilege, the success of the target company's venture might be jeopardized.

⁹⁸ See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 548 (1949).

⁹⁹ Brereton, *Abrogation of the Corporate Privilege in Stockholder Suits*, 15 *PRAC. LAW.*, July 1969, at 24, 27. The purpose of the derivative suit, however, seems to militate against the author's contentions. In a derivative action, the wrong sought to be redressed is not a personal wrong to the individual plaintiff. Rather, the plaintiff sues on behalf of the corporation for a cause of action it has failed to assert. Additionally, all proceeds resulting from a successful suit revert to the corporation. *Smith v. Sperling*, 354 U.S. 91, 99 (1957) (Frankfurter, J., dissenting). Thus, since in a derivative action the corporation is the actual injured party plaintiff and since the privilege is designed to protect the corporate client, the corporation would be, in effect, invoking the privilege of silence against itself.

¹⁰⁰ See notes 69-78 *supra*.

¹⁰¹ See 49 N.C. L. REV. 802, 806 n.24 (1971), wherein it is stated that "[b]y utilizing complicated organizational structures, vast numbers of agents, and advantageous accounting procedures, management can be very successful in hiding from the lay investor exactly what it is doing."

particular instance."¹⁰² Seeking to preclude an escalation of suits, the court indicated that a showing of good cause depends largely upon the nature and extent of the shareholder interest involved in the suit. Management's flexibility and freedom from harassment is protected by requiring that the shareholders show some likelihood of harm to their interests as a result of past or prospective management actions. Moreover, the court's use of an *in camera* inspection of the documents sought to be discovered will prevent revelation of corporate trade secrets.¹⁰³

The Elements of Good Cause

In setting forth one of the requirements of good cause, the *Garner* court mentioned the "obviously colorable" character of the claim of the plaintiff shareholder.¹⁰⁴ Additionally, the court alluded to the prospective crime or fraud exception in order to underscore the less than absolute nature of the privilege.¹⁰⁵

The court, while seeing no distinction between criminal acts, fraudulent transactions, or acts of questionable legality,¹⁰⁶ failed to enunciate the quantum of proof necessary to destroy the privileged nature of the communications.¹⁰⁷ Despite the confusion in this area, a case decided subsequent

¹⁰² 430 F.2d at 1103-04 (footnote omitted).

¹⁰³ *Id.* at 1104. Additionally, the *Garner* court indicated that good cause is dependent on other factors, such as: whether the document sought to be produced is identified as opposed to "the extent to which the shareholders are blindly fishing;" whether the document is material to the shareholders' claim; the necessity of the shareholders procuring the information; and, "the bona fides of the shareholders." *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 1102-03. See note 60 and accompanying text *supra*.

¹⁰⁶ 430 F.2d at 1104.

¹⁰⁷ Inasmuch as the *Garner* court's discussion of the prospective crime or fraud exception was in the context of an analogy, its standards regarding the quantum of proof necessary to vitiate the privilege must be viewed as dicta. Perhaps most of the confusion in this area is due to careless wording by courts discussing the quantum of proof necessary to defeat the attorney-client privilege. Compare *SEC v. Harrison*, 80 F. Supp. 226, 230 (D.D.C. 1948) (party seeking to overcome attorney-client privilege "must produce sufficient evidence" to show wrongful purpose), with *United States v. Shewfelt*, 455 F.2d 836, 840 (9th Cir.), *cert. denied*, 406 U.S. 944 (1972) (government must "establish a prima facie case of fraud independently" of privileged communications). Perhaps the most perplexing in this line of cases is *Pfizer, Inc. v. Lord*, 456 F.2d 545 (8th Cir. 1972) (*per curiam*), wherein the court apparently extended the burden necessary for the moving party to defeat the privilege, declaring he must produce sufficient evidence that the communications were in furtherance of an illegal purpose and make a "*prima facie* showing" of the crime or fraud. *Id.* at 549-50 (emphasis in original).

Moreover, a plausible argument can be made that the *Garner* court was giving its imprimatur to the discovery of heretofore privileged communications where a colorable showing of illegal purpose is made, in accord with an earlier decision within the Fifth Circuit, *Pollock v. United States*, 202 F.2d 281 (5th Cir.), *cert. denied*, 345 U.S. 993 (1953). *Accord*, *United States v. Billingsley*, 440 F.2d 823 (7th Cir.), *cert. denied*, 403 U.S. 909 (1971). *Contra*, *United States v. Aldridge*, 484 F.2d 655 (5th Cir. 1973), *cert. denied*, 415 U.S. 921 (1974).

to *Garner* mandates that a mere charge of wrongdoing will not be sufficient to overcome the privilege. In *IT&T v. United Telephone Co.*,¹⁰⁸ a district court located within the Fifth Circuit held that the party seeking discovery of otherwise privileged documents must make a *prima facie* showing that the challenged communications were made in furtherance of a crime or fraud.¹⁰⁹

It is submitted that requiring a *prima facie* case of fraud to be proven before the privilege is destroyed is error.¹¹⁰ If the plaintiff shareholder has the burden of actually proving fraud it may be almost impossible to do so without the aid of the privileged communications he seeks. Moreover, once a *prima facie* case of fraud is proven, the shareholder will already have proven the major part of his cause of action without the necessity of defeating the privilege.

If, however, the privilege may be vitiated upon a showing of illegal purpose, the interests of both management and the plaintiff shareholder will be served. Management will be protected from shareholders who are merely curious, but unable to provide any real justification for their desire for information.¹¹¹ Those shareholders whose rights have actually been violated, on the other hand, will be free from the abuses resulting from an overprotective, or possibly guilty management invoking the attorney-client privilege.

EXTENSIONS OF *Garner*: THE CORPORATE CLIENT IN A DUAL FIDUCIARY CAPACITY

In light of the reexamination of the traditional balance of interests advanced by *Garner*, it is evident that a similar reevaluation is warranted in cases in which either the attorney or the corporate client discovers itself in a position in which it owes fiduciary responsibilities to more than one

¹⁰⁸ 60 F.R.D. 177 (M.D. Fla. 1973).

¹⁰⁹ *Id.* at 184.

¹¹⁰ See Gardner, *A Re-Evaluation of the Attorney-Client Privilege*, 8 VILL. L. REV. 279 (1963), wherein it is suggested:

The crime or tort exception plays a valuable role in the law of attorney-client privilege. In addition to keeping the law aligned on the side of morality, in the theoretical sense, it frees the hand of counsel to aid the law in bringing to justice an unscrupulous person who would use the law for nefarious ends.

Id. at 328.

¹¹¹ Initially, lowering the evidentiary burden placed upon shareholders who seek to utilize the prospective crime or fraud exception might result in an increase in the number of shareholder suits. Exercise of *in camera* inspection of documents sought to be discovered, as well as careful examination of the pleadings and *bona fides* by the courts, however, should be sufficient to safeguard against abuses in this regard. Moreover, in response to the threat of such litigation, a corporation might also release more information to prospective plaintiff shareholders in order to discourage them from resort to the courts.

entity. Here, opportunities for speculative abuse are great since "[a] fiduciary cannot turn his responsibilities on and off like a faucet."¹¹² Thus, in situations in which one has a continuing fiduciary relationship with two different parties with adverse interests, any justification for use of the attorney-client privilege to withhold information concerning the affairs of one of these principals is highly speculative. At the same time, however, courts must take great pains to guard against opening the door to the divulgence of heretofore privileged communications to those who seek these communications merely out of curiosity or to those blindly hoping to somehow bolster an obviously frivolous claim.

In *Garner*, the court pointed to the joint attorney exception¹¹³ to underscore the necessity that corporations not be permitted to shield relevant communications from their shareholders.¹¹⁴ *Garner* drew its support for application of the joint attorney exception in shareholder suits from *Pattie Lea, Inc. v. District Court*.¹¹⁵ There, the Supreme Court of Colorado, sitting en banc, unanimously held that the statutory accountant-client privilege¹¹⁶ did not "protect a corporation from being required to disclose to its own stockholders in a derivative suit brought in good faith against the corporation, communications made by the corporation to its certified public accountant."¹¹⁷ Because the communications were made to an accountant rather than an attorney¹¹⁸ and because the court failed to indicate whether

¹¹² *Bailey v. Meister Brau, Inc.*, 55 F.R.D. 211, 214 (N.D. Ill. 1972) (mem.).

¹¹³ See notes 61-66 and accompanying text *supra*.

¹¹⁴ 430 F.2d at 1103. In this context *Garner* additionally drew, in part, from partnership cases. See *Billias v. Panageotou*, 193 Wash. 523, 76 P.2d 987 (1938) (partner cannot shield communications from other partner to partnership attorney). Again, the analogy is less than perfect. Shareholders and the corporation are linked by the joint interest of the maximization of profits. The relationship between them is not as intimate as that between partners. A partnership is entirely consensual in nature, with each partner having agency status as to the other and being subject to personal liability for partnership debts. A corporation, on the other hand, is treated as a separate legal entity, distinct from its shareholders. This results in, *inter alia*, liability for the shareholder being limited to the amount of his investment. See generally F. MECHEM, *ELEMENTS OF THE LAW OF PARTNERSHIP* §§ 7-8 (2d ed. 1920).

¹¹⁵ 161 Colo. 493, 423 P.2d 27 (1967) (en banc).

¹¹⁶ COLO. REV. STAT. ANN. § 13-90-107(f) (1973).

¹¹⁷ 161 Colo. at 497, 423 P.2d at 30.

¹¹⁸ Unlike the privilege between attorney and client, common law did not recognize an accountant-client privilege. Further, by 1968, only 15 states and Puerto Rico had conferred privileged status to communications between accountant and client. 46 N.C. L. REV. 419, 420 n.7 (1968). Moreover, federal courts have failed to extend any privilege to such communications. See, e.g., *Sale v. United States*, 228 F.2d 682 (8th Cir.), cert. denied, 350 U.S. 1006 (1956) (no privilege for accountant's work product); *Himmelfarb v. United States*, 175 F.2d 924 (9th Cir.), cert. denied, 338 U.S. 860 (1949) (privilege between accountant and client not recognized). See generally Comment, *The Functional Overlap Between the Lawyer and Other Professionals: Its Implications for the Privileged Communications Doctrine*, 71 YALE L.J. 1226, 1247-49 (1962).

the documents sought were privileged or consisted of the accountant's work product, any analogy between *Pattie Lea* and the typical derivative suit involving the attorney-client privilege would appear to be less than compelling.¹¹⁹

The analogy, though not perfect, does seem to have some relevancy in the shareholder-corporation (parent) context. For example, an attorney advising management is informing a fiduciary of the rights of his "beneficiaries." Thus, the fiduciary relationship of management to the shareholders is infused to management's agent—the attorney. The attorney, therefore, becomes the agent of both management and the shareholders, thereby furnishing the joint attorney exception with viability in this area. In light of the dual fiduciary capacity of the attorney, to permit these communications to retain their privileged character would be to allow the attorney to ignore his responsibilities towards one whom he is duty bound to protect.

Bailey v. Meister Brau, Inc.

Further amplification of the *Garner* holding was enunciated in *Bailey v. Meister Brau, Inc.*,¹²⁰ wherein the court disallowed the attorney-client privilege on the theory that a director of a corporation, serving in a dual fiduciary capacity, may not shield his communications from one of the

¹¹⁹ Interestingly, 1 year prior to *Pattie Lea*, the Colorado Supreme Court had declined to vitiate the same accountant-client privilege in a class action brought by shareholders of a transferor corporation resulting from a stock-for-stock merger. In *Weck v. District Court*, 158 Colo. 521, 408 P.2d 987 (1966) (en banc), the court held that the privilege could be asserted by the survivor corporation for four reasons: First, the survivor was not made a party to the action; second, the only persons within the class were former shareholders of the transferor—consequently, shareholders of the survivor would derive no benefit from the litigation; third, plaintiffs were afforded full access to the survivor's books and records and could conduct their own audit if they wished; and, fourth, the privilege was not waived by distribution of financial statements and annual reports by the survivor.

Commenting upon this abrupt about face, the *Pattie Lea* court merely indicated that the facts in *Weck* "differ substantially from those in the case at bar." 161 Colo. at 499, 423 P.2d at 30. Perhaps the *Weck* court was reluctant to vitiate the privilege due to the form in which the action was brought. In a class action, the corporate client derives no benefit from the litigation. In fact, any damages awarded the plaintiff shareholders deplete corporate funds. In a derivative action, however, any damages realized go to the corporation, the nominal plaintiff. See 13 FLETCHER, *supra* note 69, § 5908. Thus, in *Pattie Lea*, the corporation was attempting to invoke the privilege to its own detriment, whereas in *Weck*, the privilege was recognized as a necessary concomitant to aid the corporate client in choosing a course of action. If this interpretation is correct, its reasoning appears to be strained in that regardless of the form of the shareholder action, directors should not be able to subordinate the interests of shareholders and then cloak their actions behind the privilege. See *Weck v. District Court*, 158 Colo. 521, 525, 408 P.2d 987, 994-95 (1966) (en banc) (dissenting opinion). But cf. *Graham v. Allis-Chalmers Mfg. Co.*, 49 Del. Ch. 78, 188 A.2d 125 (1963).

¹²⁰ 55 F.R.D. 211 (N.D. Ill. 1972) (mem.).

fiduciaries upon a showing of good cause by the fiduciary. In *Bailey*, the plaintiff, a former officer, director, and shareholder of James H. Black Co., sued Meister Brau and others, alleging that they had conspired to breach his contract to purchase the company. Prior to the institution of the action, Cappadocia, a senior vice president of Meister Brau had been named president and chairman of the board of Black pursuant to Meister Brau's plans to acquire the assets of Black. While serving as an officer of both corporations, Cappadocia consulted Meister Brau's counsel concerning the acquisition of Black. During the deposition stage of the proceedings, Cappadocia refused to answer questions pertaining to the substance of these discussions, whereupon plaintiff moved to compel him to answer notwithstanding the claim of attorney-client privilege.

In framing the issue, the court recognized that Cappadocia had a dual fiduciary obligation. As vice president of Meister Brau, he was responsible to that corporation and its shareholders.¹²¹ Similarly, as president and chairman of the board of Black, he owed a concurrent fiduciary obligation to that corporation and its shareholders.¹²² The *Bailey* court recognized *Garner*, although factually different, as providing the proper framework for confronting attorney-client privilege questions, noting that it "sets up an approach to problems involving the privilege that seems applicable here."¹²³

In ruling that the privilege did not attach to Cappadocia's communications, the court was careful to note that, in and of itself, the dual fiduciary capacity of Cappadocia would not be enough to destroy the privilege.¹²⁴ Good cause, as defined by *Garner*, is, the *Bailey* court ruled, a necessary concomitant to the nonavailability of the privilege in situations in which a corporate officer serves in a dual fiduciary capacity.¹²⁵ The court was able to dispose of the good cause requirement easily, noting that "[p]laintiff's claim contains substantial allegations of wrongful action by Cappadocia and others . . .,"¹²⁶ thus pigeonholing good cause, in this case, within the prospective crime or fraud exception.¹²⁷

¹²¹ See notes 69-78 and accompanying text *supra*.

¹²² *Id.*

¹²³ 55 F.R.D. at 213. Noting that in *Garner* management was linked by fiduciary duties to the FAL shareholders, the *Bailey* court declared that the interest in ascertaining management considerations "is even stronger where an executive's communications have been with counsel for a party whose interests are potentially adverse to those of the executive's shareholders, as here." *Id.* at 214.

¹²⁴ But see *Valente v. PepsiCo, Inc.*, 68 F.R.D. 361 (D. Del. 1975) (mem.), discussed in notes 129-31 and accompanying text *infra*.

¹²⁵ 55 F.R.D. at 214.

¹²⁶ *Id.*

¹²⁷ See *id.* Additionally, the *Bailey* court utilized a lesser burden of proof to vitiate the privilege than that currently utilized within the Fifth Circuit. See notes 106-11 *supra*.

Bailey thus extends the reasoning of *Garner* to suits in which the person invoking the attorney-client privilege on behalf of the corporation owes a fiduciary duty to the shareholders of two different corporations. The court's reasoning appears to be sound, inasmuch as the shareholders of Black should have the right to know the factors which Meister Brau considered in deciding the fate of their company. By permitting discovery of these communications, the court, in effect, ensured that Meister Brau could not legally subordinate the rights of the Black shareholders in order to further Meister Brau's interests. In addition, by hinging the availability of the privilege upon a showing of good cause by the party who seeks to discover these heretofore privileged communications, the court allowed reasonable discovery, consistent with the Federal Rules of Civil Procedure,¹²⁸ while at the same time preserving the privilege in the proper circumstances.

THE PRIVILEGE IN PARENT-SUBSIDIARY RELATIONS: *Valente v. PepsiCo, Inc.*

Recently, in *Valente v. PepsiCo, Inc.*,¹²⁹ a decision of potential importance, a district court refused to allow a parent corporation to invoke the attorney-client privilege against minority shareholders of its subsidiary. The court based its reasoning not upon *Garner*, but rather upon well-established fiduciary principles, eliminating from its consideration any inquiry as to good cause. In so doing, the court may have opened the door to a flood of vexatious and irresponsible lawsuits by shareholders of a subsidiary seeking privileged information from the parent to substantiate spurious claims.¹³⁰

In 1970, PepsiCo, Inc., desiring to acquire full control of Wilson Sporting Goods Co. (Wilson), acquired 74 percent of the outstanding Wilson shares in a single purchase, later acquiring an additional 6 percent through purchases on the open market. Pursuant to its plan, PepsiCo offered the minority shareholders of Wilson \$17.50 for each of their shares. Additionally, holders of Wilson warrants, exercisable until 1979 at \$20.50 per share, were offered \$3.50 for each warrant. Alleging that PepsiCo had made material misrepresentations to holders of Wilson securities, and also that the purchase price offered to Wilson shareholders and warrant holders was unfair, plaintiffs instituted a class action claiming violations of the federal securities laws, as well as pendent claims of fraud.¹³¹ Upon refusal by

¹²⁸ See note 6 and accompanying text *supra*.

¹²⁹ 68 F.R.D. 361 (D. Del. 1975) (mem.).

¹³⁰ See notes 156-60 and accompanying text *infra*.

¹³¹ Plaintiffs alleged that prior to an unfavorable Internal Revenue Service ruling concerning the proposed merger of Wilson into PepsiCo, PepsiCo had manifested to the Wilson warrant holders that they would be treated as Wilson shareholders upon the merger. After PepsiCo had refused to permit inspection of the documents prepared by its counsel concerning the rights of the Wilson minority, claiming they were protected by the attorney-client privilege,

PepsiCo to produce certain documents on the ground that they were privileged, plaintiffs moved to compel disclosure, asserting that the privilege was unavailable to a parent against the minority shareholders of its subsidiary.

Parent's Duty to Its Subsidiary

In order to examine the bases upon which the *Valente* court rested its decision it is first necessary to examine some of the considerations with which it dealt.

Although the scope of the corporate fiduciary doctrine has been cloudy, its thrust remained constant, *i.e.*, regardless of who controls a corporation or its subsidiary, a fiduciary duty is owed to any entity under its domination.¹³² Correlative to this duty is the doctrine that the majority shareholders of a corporation owe a fiduciary duty to both the corporation and to its other shareholders when these controlling shareholders assume the powers of directors of the corporation.¹³³ In such circumstances

[t]he directors of a corporation represent it and its stockholders; the majority stockholders of a corporation represent it and its minority stockholders. The vote of every director and of every majority stockholder must be directed to and controlled by the guiding question of what is best for the corporation, for which he is, to all legal intents and purposes, trustee.¹³⁴

Similarly, the corporate fiduciary doctrine requires the imposition of these fiduciary duties in parent-subsidiary relations.¹³⁵ Once again, the directors of the parent must deal with the subsidiary in fairness and the utmost good faith.¹³⁶ The same considerations which apply to directors of

plaintiffs moved, pursuant to FED. R. CIV. P. 37, to compel production of the documents claimed to be shielded by the privilege. See Plaintiff's Brief Supporting Motion to Compel Production of Documents and Answers to Interrogatories at 1-3, *Valente v. PepsiCo, Inc.*, 68 F.R.D. 361 (D. Del. 1975) (mem.).

¹³² See, *e.g.*, *Southern Pac. Co. v. Bogert*, 250 U.S. 483 (1919). Corporations and their shareholders are linked by fiduciary duties arising from the actuality of control, not the form. Thus, in *Southern Pacific*, the Court imposed duties of fairness and good faith on the parent because its subsidiary was the controlling shareholder in plaintiff shareholder's corporation, noting that imposition of fiduciary duties "does not rest upon . . . technical distinctions." *Id.* at 492.

¹³³ See note 72 and accompanying text *supra*.

¹³⁴ *Lebold v. Inland Steel Co.*, 125 F.2d 369, 372 (7th Cir. 1941), *cert. denied*, 316 U.S. 675 (1942).

¹³⁵ A parent-subsidiary relationship arises when one corporation acquires a controlling interest in another, regardless of whether the acquiring corporation eventually acquires full ownership. Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974) [hereinafter cited as Brudney & Chirelstein].

¹³⁶ See, *e.g.*, *Grace v. Grace Nat'l Bank*, 465 F.2d 1068 (2d Cir. 1972); *Western Pac. R.R. v. Metzger*, 197 F.2d 994 (9th Cir. 1951).

the dominating parent also apply to the majority shareholders of the parent which dominates its subsidiary.¹³⁷ One commentator, in fact, submits that "[t]he power to control . . . should be considered in no lesser light than that of the power of a trustee to deal with the trust estate and with the beneficiary."¹³⁸

Rights of Minority Shareholders of the Subsidiary

In construing the dealings of the parent with its subsidiary, courts, on the whole, have subjected these transactions to what is termed the fairness doctrine.¹³⁹ Basically, fairness requires "that upon a merger the minority stockholder shall receive the substantial equivalent in value of what he had before."¹⁴⁰ Due to the complexity of corporate finance and accounting procedures, however, any determination of what is a fair return for these minority shareholders is usually extremely difficult.¹⁴¹ Accordingly, courts have tended to look upon these exchanges as arm's length transactions, with each party bargaining in good faith as equals, and have been reluctant to disturb them absent a clear showing of fraud or bad faith.¹⁴²

The realities of the situation, however, dictate a different conclusion. Rather than constituting an arm's length transaction between equals, these valuations often are the product of a single group in control of both

¹³⁷ See, e.g., *Maggiore v. Bradford*, 310 F.2d 519 (6th Cir. 1962); *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951), *aff'd*, 235 F.2d 369 (3d Cir. 1956). *Contra*, *Geller v. Transamerica Corp.*, 53 F. Supp. 625 (D. Del. 1943) (majority shareholders owe no fiduciary duty to minority).

¹³⁸ N. LATTIN, CORPORATIONS, ch. 12 § 8, at 565 (1959).

¹³⁹ See generally Note, *The Fiduciary Duty of Parent to Subsidiary Corporation*, 57 VA. L. REV. 1223 (1971); Note, *Corporate Fiduciary Doctrine in the Context of Parent-Subsidiary Relations*, 74 YALE L.J. 338 (1964).

¹⁴⁰ *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 306, 93 A.2d 107, 114 (1952).

¹⁴¹ There is considerable disagreement over the question whether the parent must share any tax benefits resulting from the merger with the shareholders of the subsidiary. See *Brudney & Chirelstein*, *supra* note 135, at 309-13 (submitting that tax gains should be shared by the subsidiary but recognizing existing law is to the contrary). Moreover, the allocation of good will upon the sale of the disappearing corporation is oftentimes a difficult task. *Cf.* *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955). There, the lower court found that \$20 per share was a fair price for the control block of corporate stock, reasoning that the market price had not exceeded \$12 per share. It found that the increased price was due to the transfer of corporate power, ignoring the fact that a shortage of the steel products manufactured by the corporation existed at the time of the sale. The Court of Appeals for the Second Circuit reversed, holding that the dominant shareholders, who negotiated the price, were responsible to the minority as fiduciaries. The price of the sale, the court declared, was not limited to the tangible balance sheet assets of the corporation. Where the dominant shareholders undervalued the rights of the minority by not including the good will arising from the steel shortage and favorable market conditions in the purchase price, they did not meet the high standard of loyalty owed by a fiduciary to his principal.

¹⁴² See, e.g., *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939).

the parent and the subsidiary.¹⁴³ Characterizing dealings between a parent and its subsidiary as an arm's length transaction ignores the degree of control possessed over the subsidiary by the parent.¹⁴⁴ Some degree of this inherent unfairness can be ameliorated through the exercise of appraisal rights¹⁴⁵ by the minority with the concomitant requirements of full disclosure¹⁴⁶ even where the vote of the minority shareholder is arithmetically useless.¹⁴⁷ Yet, even with full disclosure of the facts underlying the valuation of the minority shareholder's interest, the natural tendency of the parent to value the assets of the subsidiary as low as possible seems to militate against the minority shareholder receiving the same value for his

¹⁴³ In circumstances in which the negotiation of merger agreements is the product of two boards of directors with common members, the contracting boards may not be dealing with each other at arm's length. Negotiations, supposedly engineered by adverse parties, may in fact be between the same persons, resulting in a transfer which is invariably in favor of the dominant party. While the existence of interlocking directorates in negotiations does not in and of itself constitute fraud, a stricter standard of scrutiny should be employed in reviewing the fairness of such transactions. See 15 FLETCHER, *supra* note 69, § 7160, at 255-57. See, e.g., *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590 (1921), wherein the Court condemned the actions of interlocking directors in selling all the assets of an unprofitable subsidiary to the parent, finding the price paid to the subsidiary's shareholders inadequate. The Court noted that the dissolution of the subsidiary was justified due to the exigencies of the market, but felt that sale of the assets at a public sale would be a more realistic valuation of the minority's interest. In so holding, the Court declared that in such a situation, "where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness" *Id.* at 599 (citations omitted).

¹⁴⁴ As the degree of control exercised by the parent increases, the options left open to the minority shareholders of the subsidiary proportionately decrease. Professor Eisenberg has noted that as the parent's interest in the subsidiary approaches complete control, the market for the subsidiary's stock virtually disappears, a situation that is aggravated if the parent, for its own business purposes, reduces or eliminates dividends. Eisenberg, *The Legal Role of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 132-33 (1969).

¹⁴⁵ But see Brudney & Chirelstein, *supra* note 135, at 304-07.

¹⁴⁶ In addition to being necessary for the exercise of appraisal rights, full disclosure of the terms and consequences of the merger to the subsidiary's shareholders serves at least two other purposes. First, disclosure will inform the public so as to permit well-reasoned decisions about buying, selling, or holding the securities of the corporations involved in the merger. See generally *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969). Second, disclosure of merger terms could trigger either modification or at least reconsideration of the offer. Hence, if the merger terms were unfair, the parent might change them rather than subject itself to either a suit by the minority or a possible SEC enforcement action. See, e.g., *Rosenblatt v. Northwest Airlines, Inc.*, 435 F.2d 1121, 1124 (2d Cir. 1970). See also Brudney & Chirelstein, *supra* note 135, at 301-04. Moreover, nondisclosure by the parent subjects it to suit regardless of whether the merger price was fair. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 378, 381, 386 (1970) (disclosure requirements intertwined with fairness considerations); *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. 66, 99-100 (E.D.N.Y. 1969), *aff'd*, 478 F.2d 1281 (2d Cir. 1973) (notwithstanding fairness of exchange rate, parent's material omission gives rise to liability).

¹⁴⁷ Brudney & Chirelstein, *supra* note 135, at 301.

interest as he might receive upon dissolution.¹⁴⁸ Thus, it is imperative that in ascertaining the rights of minority shareholders when it is claimed that the parent has not afforded the minority full disclosure or has provided them with an unfair valuation of their interests, the court views with skepticism any withholding of relevant information concerning the exchange rate by the parent on the ground that it is shielded by the attorney-client privilege.

The Fiduciary Duty Exception

In light of the aforementioned considerations, the *Valente* court held that the right of the Wilson minority shareholders to full and fair disclosure of the considerations PepsiCo took into account in the valuation of their interests outweighed the protective cloak of the attorney-client privilege. Noting that the situation involved in the instant case was "more complex than a mere waiver problem,"¹⁴⁹ the court undertook "an examination of the function of the [privilege], and of the role of attorneys and other fiduciaries in light of the requirements of the law."¹⁵⁰ Recognizing that the privilege retains vitality in the corporate arena, the court was nevertheless aware of the reasoning of *Garner* and *Bailey*, though it felt they were "not controlling since we deal here with the application where a minority shareholder seeks information not from his own corporation, but from a separate corporation which was a controlling shareholder in his."¹⁵¹

¹⁴⁸ See generally Note, *The Fiduciary Duty of Parent to Subsidiary Corporation*, 57 VA. L. REV. 1223, 1226-27 (1971).

¹⁴⁹ 68 F.R.D. at 366 (footnote omitted). Plaintiffs claimed that by answering a question during deposition concerning the rights of the Wilson warrant holders, PepsiCo had waived the protection afforded by the confidential attorney-client relationship. Plaintiff's Brief Supporting Motion to Compel the Production of Documents and Answers to Interrogatories at 10-13. The court disagreed, holding "there was no knowing waiver of the privilege, but merely an identification of the witness' own ideas." 68 F.R.D. at 366 n.9.

The court's decision appears to be correct, in that whenever a claim of privilege is asserted, the alleged holder of the privilege is required to identify the communication. See, e.g., *International Paper Co. v. Fibreboard Corp.*, 63 F.R.D. 88, 93 (D. Del. 1974). In order to waive the attorney-client privilege, the privilege holder must make his intention clear, whether by acts or implication. See 8 WIGMORE, *supra* note 1, § 2327, at 634-39; *Bierman v. Marcus*, 122 F. Supp. 250 (D.N.J. 1954) (client's testimony on privileged communication waives all other communications on same matter); *In re Associated Gas & Elec. Co.*, 59 F. Supp. 743 (S.D.N.Y. 1944) (voluntary testimony regarding privileged matter at earlier hearing waives privilege at subsequent litigation).

¹⁵⁰ 68 F.R.D. at 366 (footnote omitted).

¹⁵¹ *Id.* at 367 (footnote omitted). It is submitted, however, that *Bailey* was sufficiently analogous to *Valente* to warrant closer examination by the court. In both cases, the asserted holder of the privilege was in a conflicting fiduciary capacity: Cappadocia, to the shareholders of Black and Meister Brau, see notes 120-22 and accompanying text *supra*; PepsiCo, to its own shareholders and the minority shareholders of its subsidiary, Wilson. Moreover, in both cases,

The court divided the documents sought by the Wilson minority into two classes: First, two documents drafted by counsel for PepsiCo while they were sitting on the Wilson board of directors; and, second, several documents drafted by PepsiCo attorneys concerning the rights of the Wilson minority shareholders.¹⁵² Ruling the first class of documents were not privileged since they fell under the joint attorney exception,¹⁵³ the court was able to dispose of this question rather easily. While the PepsiCo attorneys were not sitting on the Wilson board in their capacity as attorneys, it is nevertheless clear that as members of the Wilson board, they owed to the Wilson minority a fiduciary duty similar to that duty owed to PepsiCo in their capacity as attorneys. Allowing these attorneys to shield relevant information concerning the rights of the Wilson minority on the ground that these communications were privileged matters between PepsiCo attorneys (Wilson board members) and PepsiCo, would be tantamount to permitting PepsiCo to subordinate the rights of the Wilson minority.

It is in its discussion of the second class of documents, those drafted by PepsiCo attorneys concerning the rights of the Wilson minority, that the *Valente* court's reasoning becomes tenuous. *Valente* posits that PepsiCo, in its capacity as controlling shareholder of Wilson, owed a fiduciary duty to the Wilson minority, and that this same duty was infused through PepsiCo to the PepsiCo attorneys. Thus, the court stated:

The attorneys whose opinions were written to PepsiCo could not avoid PepsiCo's own obligations as a fiduciary. Where the fiduciary has conflicting interests of its own, to allow the attorney-client privilege to block access to

the party seeking to overcome the privilege was a minority shareholder of a corporation dominated by a more powerful parent.

¹⁵² To facilitate discussion, the six documents sought to be discovered by the Wilson minority will be listed.

Class 1

Document 1: Memorandum from PepsiCo general counsel, sitting on the Wilson board of directors, concerning acquisition of Wilson minority interests.

Document 2: Legal opinion from PepsiCo outside counsel, serving on the Wilson board, concerning the merger and rights of the parties.

Class 2

Document 3: Memorandum from PepsiCo house counsel to PepsiCo executive concerning alternative in event of unfavorable revenue ruling.

Document 4: Memorandum from outside counsel for PepsiCo discussing acquisition of Wilson shares.

Document 5: Memorandum from house counsel to PepsiCo executive discussing an alternative course of action in the event of an unfavorable tax ruling.

Document 6: Legal opinion sent by Delaware outside counsel to New York outside counsel concerning rights of Wilson minority under Delaware law.

68 F.R.D. at 366 n.8.

¹⁵³ See notes 61-66 & 113-19 and accompanying text *supra*.

the information and bases of its decisions as to the person to whom the obligation is owed would allow the perpetration of frauds.¹⁵⁴

While the court's reasoning in this phase of its inquiry appears to be sound, it is submitted the inquiry was incomplete. Properly limited, the dual fiduciary capacity of the PepsiCo attorneys should outweigh the attorney-client privilege only upon a showing of good cause by the Wilson minority. Moreover, it appears that by limiting its inquiry to the fiduciary capacity of the PepsiCo attorneys, the *Valente* court was departing from the well-reasoned, practical principles advanced by *Garner*. It should be noted that the *Valente* court did seem to pay lip service to the elements of good cause, noting that there are "limits"¹⁵⁵ on its holding. Nevertheless, by excluding good cause from its inquiry, the court may have unwittingly opened the door to abuses not present in the instant case.

For example, the *Valente* holding is in direct conflict with the reasoning of an earlier decision, *In re Prudence-Bonds Corp.*¹⁵⁶ There, the court refused to circumvent the privilege for the benefit of bondholders seeking access to privileged communications made to the bond trustee on the theory that the trustee should be able to administer his trust free from vexatious interference.¹⁵⁷ Furthermore, by refusing to even consider the extent of shareholder interest represented in the *Valente* action, the court may have indirectly fostered a proliferation of suits by a small minority who wrongly feel the majority has acted adversely to their interests or who bring an action in bad faith, hoping for an advantageous settlement by a defendant corporation not inclined to litigate the issue.¹⁵⁸

Moreover, it is conceivable that, in a battle for corporate control, a defeated tender offeror (A) may sue the acquiring corporation (B), claiming violation of the SEC proxy rules¹⁵⁹ or the Williams Act,¹⁶⁰ and seek

¹⁵⁴ 68 F.R.D. at 369 (footnote omitted).

¹⁵⁵ *Id.* at 370. Thus, the court stated:

Were the claim here one made in bad faith, or one where the interests of the great majority of the beneficiaries would be better served by the privilege, the case would be different indeed. Similarly, if the information sought were a trade secret, or otherwise covered by other public policies which would give added weight to a need for secrecy, the obligations of the fiduciary might have entirely different circumstances.

Id.

¹⁵⁶ 76 F. Supp. 643 (E.D.N.Y. 1948), *aff'd on other grounds*, 174 F.2d 288 (2d Cir. 1949).

¹⁵⁷ See notes 82-84 and accompanying text *supra*.

¹⁵⁸ See notes 97 & 98 and accompanying text *supra*. In addition, by its refusal to examine the extent of Wilson shareholder interests involved in the litigation, the *Valente* court may have allowed discovery of confidential PepsiCo considerations by one who owns a substantial block of stock in a PepsiCo competitor. See Brereton, *Abrogation of the Corporate Privilege in Shareholder Suits*, 15 PRAC. LAW., July, 1969, at 24, 27.

¹⁵⁹ 17 C.F.R. §§ 240.14a-1 *et seq.* (1975).

¹⁶⁰ 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1970).

privileged information concerning *B*'s takeover bid. If *A* retains a minority interest in the target corporation, *Valente* would seem to mandate that the considerations which *B* used in its decision to acquire the target corporation, as well as certain information about *B* itself, would be made available to *A*, notwithstanding their privileged nature. Such a result offers widespread opportunities for abuse, especially if *A* and *B* are competitors. To permit *A* to discover the market factors *B* considered significant might effectively destroy any competitive advantage which *B* enjoys.

It is submitted, therefore, that the elements of good cause, as defined by *Garner*, should have been incorporated into the *Valente* court's inquiry. Thus, had the Wilson minority made a colorable showing of violations of the securities laws, PepsiCo's privilege claim would have been defeated.¹⁶¹ By neglecting to pursue the final phase of what ideally should be a two-step inquiry, the *Valente* court has declined to follow existing case law, bypassing the built-in safeguards afforded by the good cause requirement and thereby permitting the Wilson minority to intrude upon PepsiCo's privileged relationship with its attorneys.

CONCLUSION

It is now apparent that despite its seeming simplicity, the attorney-client privilege in the federal courts today is a mass of conflicting precedents and policies. While the privilege remains a widely accepted rule of evidence, it has occasionally been the subject of violent criticism as an obstacle in search of the truth.¹⁶² Yet, its vitality remains intact,¹⁶³ albeit

¹⁶¹ See, e.g., *Bailey v. Meister Brau, Inc.*, 55 F.R.D. 211, 214 (N.D. Ill. 1972) (mem.).

¹⁶² See, e.g., J. BENTHAM, *Rationale of Judicial Evidence*, in 7 THE WORKS OF JEREMY BENTHAM 743 (J. Bowring ed. 1962). Bentham attacked the privilege on the grounds that only the client who has something to conceal benefits from the attorney-client privilege, and he is not worthy of protection. The litigant whose hands are clean, on the other hand, has no need of the protection afforded by the privilege since he has nothing to hide. Wigmore counters Bentham's argument by pointing out that there is "no hard and fast line between guilt and innocence;" thus, the innocent client who discloses a fact fatal to his defense is not *ipso facto* unworthy of protection. 8 WIGMORE, *supra* note 1, § 2291, at 552 (emphasis in original). Moreover, Wigmore submits that the privilege actually has the tendency to discourage litigation. When the attorney becomes aware of all the facts within the knowledge of his client, he is able to weed out spurious claims and advise against their prosecution. *Id.*, at 550-54.

Some commentators have suggested that the privilege serves no useful purpose and that the actual reason for its preservation is sentimentality on the part of the bar to inhibit any forced breach of attorney-client confidences. See, e.g., Radin, *The Privilege of Confidential Communications Between Lawyer and Client*, 16 CALIF. L. REV. 487, 492-93 (1928).

¹⁶³ One study, however, indicates that freedom of consultation between attorney and client would not really be adversely affected by abolition of the privilege. The *Yale Law Journal* discovered that out of 108 laymen polled, 55 believed lawyers could not be required to reveal their confidential communications, whereas the remaining 53 did not know or felt an attorney could be compelled to betray their confidences. Moreover, when questioned whether they

fragmented. Thus, district courts are often forced to analyze the thrust of the privilege without resort to Supreme Court guidelines¹⁰⁴ or statutory restraints, leaving each district court to develop its own concept of the role of the corporate client or the role of the privilege in shareholder suits. If the privilege is to exist at all, certainty should be its goal, so that an attorney will know, in advance, whether a document will be discoverable by an adversary. It is submitted, then, that Congress reconsider defining and delineating the scope of the privilege to arrest this trend towards balkanization.

would be less likely to give all relevant information to counsel absent the privilege, 55 indicated they would be less likely, 37 did not feel they would be less likely, and 16 did not know. Comment, *Functional Overlap Between the Lawyer and Other Professionals: Its Implications for the Privileged Communications Doctrine*, 71 YALE L.J. 1226, 1261-62 app. (1962).

¹⁰⁴ The last time the Supreme Court agreed to review a question regarding the scope of the attorney-client privilege was in 1971. Its final decision, however, had no precedential implications, leaving the definition of the corporate client an open question. *Harper & Row Publishers, Inc. v. Decker*, 400 U.S. 348 (1971), *aff'g per curiam by an equally divided Court* 423 F.2d 487 (7th Cir. 1970) (*per curiam*).